

Audit Manual

Chapter 8

Bars and Restaurants



Sales and Use Tax Department

*California State
Board of Equalization*

This is an advisory publication providing direction to staff administering the Sales and Use Tax Law and Regulations. Although this material is revised periodically, the most current material may be contained in other resources including Operations Memoranda and Policy Memoranda.

Please contact any board office if there are concerns regarding any section of this publication.

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AUDIT MANUAL

BARS AND RESTAURANTS

0800.00

INTRODUCTION

0801.00

GENERAL

0801.05

It is the purpose of this section of the manual to include information to assist in the audits of bars, restaurants, and other similar establishments. Notwithstanding the information included in Audit Manual Chapter 4, General Audit Procedure, this section is intended to assist the auditor in developing and applying the standard and specialized audit techniques to bars and restaurants. This section will initially address those topics applicable to both bars and restaurants, followed by sections specific to bar and restaurant auditing respectively. The auditor should recognize that there are many variations in the auditing procedures, which are necessitated by the application of the law, rules, regulations, the taxpayer's method of reporting, and types of records encountered. By the very nature of the business (bar and/or restaurant), most sales are generally subject to tax. Therefore, in bar and restaurant auditing, it will often be necessary to verify or establish gross receipts and make allowances for exempt or nontaxable sales.

A preliminary review of the business operations is essential in bar and restaurant auditing. Although a restaurant may contain a bar or sell alcoholic beverages, not all bars contain restaurants or sell food. Some bars may have a full service restaurant while others provide a minimal selection of food as a courtesy or complimentary to its patrons. In many bars that sell food, the premises where the food is served are separated from the bar. In either case, food and bar sales should normally be segregated in the taxpayer's records. When performing an audit of a bar combined with restaurant activities, it is imperative that the auditor separates the two activities. The procedures that follow are not intended to be a substitute for independent thinking and sound judgement on the part of the auditor. All information used to establish sales must be included in the audit working papers to support the auditor's recommendation.

INSPECTION OF PREMISES

0801.10

Whenever possible, the auditor should inspect and, if practical, perform the audit at the business premises. If the audit is not conducted at the business premises, the auditor should make an effort to observe the bar and/or restaurant in operation. If the auditor does not observe the business operations or is unable to observe the business operations, an explanation must be provided in the audit working papers.

When the audit is to be transferred to another district, a Bar Fact Sheet and other significant information regarding the business should be prepared by the district in which the bar and/or restaurant is located, and all the information should be forwarded with the assignment and a Waiver of Limitations, when appropriate.

SPECIAL PROCEDURES**0801.15**

Prudent tax auditing requires that the auditor observe and evaluate factors outside the accounting records, and document in the audit working papers information on the following:

- Physical characteristics of the business premises
- Number of days of operation
- Hours of operation
- Type of facilities available (number of chairs, tables, stools, etc.)
- Number of cash registers
- Number of employees
- Type of patronage
- Lifestyle of the taxpayer
- Expected sales based on the auditor's observation of the business activity
- Changes that have occurred during the audit period (e.g. , expansion of the business)

Chapter 4 of the Audit Manual describes general auditing procedures that may be useful in any sales tax audit. Many of these procedures are applicable to audits of bars and restaurants; however, additional procedures and techniques have been developed in response to issues that are unique to the bar and restaurant industry. These techniques and procedures are described in the following sections.

Additional information may also be obtained by contacting other agencies, such as the local Alcoholic Beverage Control or Employment Development Department. The auditor should be aware that industry-wide reports are available detailing historical studies on average food costs, average pour costs, sales volume per seat, sales volume per employee, and other operating ratios. Comparison of audited and reported operating results with recognized industry averages may indicate whether reported or audited results are reasonable. The auditor should consult with his or her supervisor with respect to industry averages. In addition, current and historical telephone directory yellow pages, which can be found at local libraries, may be useful in determining the start date of a segment or second location of a taxpayer's business.

ADEQUACY AND COMPLETENESS OF RECORDS**0801.20**

The auditor should include comments in the working papers describing the procedures used by the taxpayer to record business transactions, methods and procedures used for reporting, what records were made available, and whether the records available for audit were complete. At a minimum, the auditor should review the following records:

- Federal income tax returns (FITR's), including all schedules
- Profit and loss statements
- All journals and books of account
- Sales and use tax returns and all supporting documentation, including daily worksheets
- Bank statements and cancelled checks if available
- Purchase invoices (including cash paid outs)
- Cash register tapes
- Documentation regarding self-consumption
- Source documents to support all sources of income and expenses
- Documentation to support excess monies received from non-operating sources (i.e., loans, insurance proceeds, video games and other vending machines, etc.)

ADEQUACY AND COMPLETENESS OF RECORDS**(CONT.) 0801.20**

In addition to supporting total sales, cash register tapes are an important part of the records of a bar and/or restaurant. The cash register tapes may be used to support price changes, cocktail sales, "happy hour" sales, specials, two-for-one promotions, and price increases during periods when entertainment is provided, etc. If the taxpayer contends that the business operations have changed during the audit period, a review of the cash register tapes may also provide the documentation needed. In addition, in any bar audit, if the taxpayer contends that no liquor, beer, or wine was sold during a specific period of the audit, the auditor should contact the Alcoholic Beverage Control to verify the type(s) of licenses issued to the taxpayer and the corresponding date(s) each license was issued. This information must be documented in the audit working papers. The auditor should also verify purchases of liquor, beer, and wine with local vendors.

ADJUSTMENTS FOR SELF-CONSUMED MERCHANDISE**0801.25**

Almost every bar and restaurant has self-consumed merchandise. Some of the more common uses are:

- Gifts of package goods
- Home consumption by taxpayer(s)
- Drinks and/or food consumed by taxpayer on premises
- Drinks consumed by employees on premises
- "Treating" customers
- Employee meals
- Food used for complimentary hors d'oeuvres

Self-consumption of both food and beverages should be discussed at the beginning of the audit with the taxpayer and the amount of alcohol noted on the Bar Fact Sheet (Exhibit 2). Adjustments should always be given for self-consumed merchandise in auditing bars and restaurants, except in situations as found in Section 0801.30. Since taxpayers seldom maintain records of self-consumption, the auditor should, with the aid of the taxpayer, estimate the amount as realistically as possible. *If an understatement in self-consumed merchandise is established, it should be shown separately in the audit report.*

Note: Use tax should be assessed on self-consumed merchandise when material.

SELF-CONSUMED MERCHANDISE DISCLAIMED**0801.30**

A taxpayer, fearful that he or she has committed an illegal act, may falsely tell the auditor that they do not have any self-consumption, especially of alcoholic beverages. The auditor should point out to the taxpayer the effect self-consumption has on sales computed by the mark-up method. If the taxpayer still insists no food or beverages are consumed in any manner, no adjustment should be made for this item in computing sales, and the auditor should make comments to this effect in the audit working papers. However, if the taxpayer later states that they actually did have some self-consumption, an adjustment should be made for the amount of self-consumption. The Bar Fact Sheet (if applicable) should also be revised to reflect any changes in the amount of self-consumption purported by the taxpayer.

LOSSES BY FIRE**0801.35**

Occasionally, taxpayers will state that merchandise has been destroyed by fire. The 2% pilferage allowance discussed in Sections 0804.47 and 0809.30 does not include loss from fire. In addition to the allowance for pilferage, the auditor should make an adjustment for claimed loss due to fire if it is supported by evidence from the taxpayer or representative(s). Examples of such support include:

- A report to the police department giving the date of the fire and approximate loss
- A fire department report
- A claim for loss filed with an insurance company

Losses of money by fire cannot be offset against taxable sales since the sale has already taken place and thus the tax is owed to the state.

LOSSES RESULTING FROM NATURAL DISASTERS**0801.40**

Earthquakes, floods, and hurricanes are examples of losses by natural disasters. The 2% pilferage allowance discussed in Sections 0804.47 and 0809.30 does not include natural disasters. In addition to the allowance for pilferage, the auditor should make an adjustment for claimed loss resulting from natural disasters if it is supported by evidence from the taxpayer or representative(s). In many instances, the taxpayer will have insurance to cover such losses, and documentation concerning a settlement with the insurance company will be sufficient evidence of loss. In the event the taxpayer does not have insurance, a reasonable allowance should be made based upon any valid information obtainable.

SALES TAX INCLUDED**0801.45**

Certain presumptions concerning the addition of sales tax reimbursement are created by Civil Code Section 1656.1. It shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail to a purchaser if:

- The agreement of sale expressly provides for such addition of sales tax reimbursement;
- Sales tax reimbursement is shown on the sales check or other proof of sale; or
- The retailer posts in his or her premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable.

It shall be presumed that the property, the gross receipts from the sale of which is subject to sales tax, is sold at a price which includes sales tax reimbursement if the retailer posts in his or her premises, or includes on a price tag or in an advertisement (whichever is applicable) one of the following notices:

- “All prices of taxable items include sales tax reimbursement computed to the nearest mill.”
- “The price of this item includes sales tax reimbursement computed to the nearest mill.”

Notwithstanding the above, it is the overwhelming custom of the bar trade to serve alcoholic beverages tax included. Some bars with restaurants sell their drinks for a “tax-included” price at the bar, but in the restaurant sell the drink without tax reimbursement for the same price and separately add tax reimbursement. The auditor must be aware of the different ways for handling sales tax reimbursement to ensure the proper selling price is obtained. The auditor should also verify whether the recorded sales in both restaurants and bars are ex tax or tax included by conducting a random test of sales tickets or cash register tapes.

BAR AUDITING PROCEDURE**0802.00****GENERAL****0802.05**

A preliminary review of the business operations is essential in bar auditing. The following procedures should be used as a guideline in making a determination as to the accuracy of the recorded sales. While acceptable, any deviation from the established review procedures must be fully documented and explained in the audit working papers. Due to the variety of retail establishments that serve alcoholic beverages, the Audit Program for Bars, Appendix A, is provided as a guideline to assist the auditor in planning and conducting a routine bar audit.

All information used to establish sales must be included in the audit working papers to support the auditor's recommendation. Although the importance and utility of quantitative analysis in computing audit deficiencies cannot be discounted, such an approach should be used only when there are adequate reasons for disregarding the taxpayer's recorded sales.

If the taxpayer's recorded sales are impeached and sales are established by generally accepted tax-auditing procedures (i.e., the mark-up method or other auditing technique), the auditor must explain why it was necessary to disregard the taxpayer's records.

DEFINITION**0802.10**

For purposes of this chapter, a bar is defined as any retail establishment serving alcoholic beverages. Exhibit 1 identifies the various types of alcoholic beverage retailers.

BAR FACT SHEET**0802.15**

The preparation of Form BOE-1311-B, Bar Fact Sheet (Exhibit 2), is an essential and required preliminary step in any bar audit. The Bar Fact Sheet will assist the auditor and taxpayer in documenting the essential information needed to perform a bar audit. This form is to be used as a tool to gather information in conducting bar audits, as well as to ensure the taxpayer is aware of important considerations that might impact the audit. The Bar Fact Sheet provides documentation for many areas that affect a bar markup, such as:

- Pour size and glass sizes (including changes during entertainment, "happy hour" and special events)
- Drink prices (including changes during entertainment, "happy hour" and special events)
- Estimated percentage of sales by category, (i.e., mixed drinks, cocktails, or "on-the-rocks")
- Theft (pilferage), fire loss, and loss due to natural disasters
- Self-consumption

BAR FACT SHEET

(CONT. 1) 0802.15

This form must be completed at the beginning of the audit. The information to be entered on the Bar Fact Sheet must be obtained from the taxpayer or someone authorized to act on his or her behalf. When possible, the Bar Fact Sheet should be completed with the assistance of a full-time bartender who has been employed for a significant length of time, which would allow him or her to be very familiar with the bar's standard operations. The completed fact sheet should be read and signed by the person who provided the information. *If someone other than the taxpayer provided the information, the form should also be read and signed by the taxpayer.* If an "absentee-taxpayer" provides the information, the auditor should request the taxpayer's permission to verify the accuracy of the information with a full-time bartender who has been employed by the taxpayer for a length of time. If there is an inconsistency between the information provided by the absentee-taxpayer and the bartender, the auditor should discuss the differences with the taxpayer and if the taxpayer is in agreement, a revised Bar Fact Sheet should be prepared for the taxpayer's signature that reflects the change(s). However, if the taxpayer declines the auditor's request to verify the information presented or if the taxpayer is in disagreement with the bartender's statements, the auditor should document such disagreement in the audit working papers.

The size of drinks reflected on the Bar Fact Sheet should be consistent with the size of the jiggers and glasses used at the bar. If drink sizes were changed during the audit period, purchase invoices may be available that reflect new glassware or jigger purchases. Changes in selling prices, sales at lower prices during "happy hour," and sales at higher prices when entertainment is provided or a special event is held can often be established from cash register tapes. Whenever possible, the auditor should attach a copy of the drink price menu to the Bar Fact Sheet.

The Bar Fact Sheet will provide much of the information that will be needed later to complete the audit working paper documentation and comments. The information documented on the Bar Fact Sheet may be modified/revised by additional information or estimates provided by the taxpayer based upon information obtained during the audit. If significant changes are necessary to the original Bar Fact Sheet, a revised Bar Fact Sheet should be prepared for the taxpayer's or representative's signature. The words "REVISED" should be written in the top right hand corner of the document. A copy of both the original and revised Bar Fact Sheet should be provided to the taxpayer and/or representative. The auditor may not alter the information on the Bar Fact Sheet without the taxpayer's knowledge and permission. If there are minor changes to the original Bar Fact Sheet, the auditor should have the taxpayer/representative initial and date the change(s). The original Bar Fact Sheet and any revised Bar Fact Sheet(s) must be included in the audit working papers as a subsidiary schedule(s).

It is important that the taxpayer is made aware that the Bar Fact Sheet data may be used to establish audited bar sales and the auditor must disclose this fact to the taxpayer before preparing the form. The statement at the bottom of the Bar Fact Sheet states:

Please Read Before Signing:

The completion of the Bar Fact Sheet is a collaborative effort by the auditor and taxpayer to document the essential information needed to perform an audit of a bar, and **this information may be used to establish audited bar sales.** If someone other than the taxpayer has provided the information, the form should also be reviewed and signed by the taxpayer. The information documented on this form may be modified/revised by additional information or estimates provided by the taxpayer. If an audit conclusion is based on information other than that contained in this Bar Fact Sheet, such information must be fully documented in the audit working papers and discussed with the taxpayer.

BAR FACT SHEET**(CONT. 2) 0802.15**

Therefore, if the audit conclusion is based on information other than that contained in the Bar Fact Sheet(s); such information must be fully documented in the audit working papers and discussed with the taxpayer. Additionally, if the auditor is going to disregard some or all of the information contained on the Bar Fact Sheet(s) (e.g. size of pour), the reasons must be clearly stated with detailed comments and/or supported with testing.

To ensure the accuracy and to prevent any misunderstanding of the information provided, this form should be completed in the presence of the auditor with the information and estimates provided by the taxpayer. The auditor should not influence the taxpayer's responses to the questions on the Bar Fact Sheet. Unless unavoidable, the Bar Fact Sheet should not be mailed or left with the taxpayer for completion. In addition, it is recommended that the auditor have the Bar Fact Sheet reviewed by the audit supervisor to ensure the form is properly filled out, signed and dated before the audit is completed.

BUSINESS LOCATION, FACILITIES, AND PATRONAGE**0802.20**

The auditor should observe and provide a general description of the bar's characteristics as set forth in Section 0801.15, such as:

- The business location (e.g., residential, industrial, urban, suburban, etc.)
- The physical facilities (e.g., number of cash registers, tables, chairs, dance floor, sound system, TV, age and condition of equipment and furnishings, etc.)
- The general nature of the customers (e.g., local residents, local employees, transient, etc.)

Such an approach is especially important in bar auditing because sales are generally for cash, the taxpayer(s) may be absent from the business premises, and employee turnover may be high. In addition, this kind of information often indicates the volume of sales, size of drinks, types of drinks, and selling prices which might be expected. It may be useful in estimating cocktail sales, "happy hour" sales, sales during entertainment periods, and self-consumption. The information may also be useful in analyzing losses incurred and/or the varying degrees of internal controls, etc.

Since a preliminary review of the business operations is essential in bar auditing, if the auditor is unable to visit the business premises, an explanation must be provided in the audit working papers.

EMPLOYEE INFORMATION**0802.25**

Through discussion with the taxpayer or his or her representative(s), and by examining the available records, the auditor should determine the number of paid bartenders and servers, the shifts worked by each, the rate of employee turnover, the level of salaries, and whether any employees have been discharged for dishonesty. Such information is valuable in judging the existence of any employee theft and determining whether all employee wages are recorded in the books. Employees working "off the books" may be a source of unreported sales that are used to pay their wages.

COMPLIMENTARY AND EMPLOYEE DRINK POLICY**0802.30**

Discussion with the taxpayer or the representative(s) and review of the taxpayer's written policies will enable the auditor to determine:

- The amount of self-consumption by taxpayer/employee
- The taxpayer's policy regarding complimentary drinks to customers
- If documentation is available to support the above items

Reviewing the taxpayer's policies, if any, and discussing the practices regarding self-consumption and complimentary drinks may also provide some insight into the degree of care exercised by employees in pouring drinks, ringing up sales, etc. If possible, an estimate of the amount of self-consumption and complimentary drinks should be discussed with each bartender, as his or her practice may differ from the taxpayer's policy.

CIGARETTE SALES**0802.35**

Some bars may sell cigarettes either through vending machines or over the counter. The auditor should first determine if the taxpayer sells cigarettes or other tobacco products. The Bar Fact Sheet contains a question regarding cigarette-vending sales. If the taxpayer does sell cigarettes or other tobacco products, the auditor should discuss such sales with the taxpayer and review purchase invoices. The auditor should obtain clarification on the following issues:

- Are cigarette (tobacco) sales segregated?
- What are the selling prices? Tax-included or ex tax?
- Rebates and incentives

A comment should be made in the audit working papers with respect to cigarette sales.

INTERNAL CONTROLS**0802.40**

The existence, or lack, of comprehensive and effective internal controls is an extremely significant factor in tax audits of bars. If such controls have been combined with a sound accounting system, it is more likely that recorded sales are not understated, unless the records have been deliberately altered. The auditor should determine the extent and nature of internal controls through discussions with the taxpayer or manager, observation, physical inspection, and examination of pertinent records. Exhibit 3 contains a "Statement of Internal Controls" that the auditor may complete with the assistance of the taxpayer. Completing a "Statement of Internal Controls" will assist the auditor (and others reviewing the audit) in understanding what type of internal controls are present in the taxpayer's business. A "Statement of Internal Controls" should be completed at the same time as the Bar Fact Sheet and, if prepared, it should be signed and dated by the taxpayer and included in the audit working papers.

The following suggest some of the internal controls used in the bar industry.

a) Cash Controls

- Are cash register drawers closed after each sale?
- Do the cash registers print sales tickets?
- Are sales tickets given to customers?
- Is access to the register tapes restricted? If so, to whom?
- Are the cash registers checked out at the end of each shift? If so, by whom?
- If two or more bartenders work simultaneously, do they use the same or different cash registers?
- Are beginning and ending register tapes (Z-tapes) in sequential order?
- Does the recorded time on the register (Z-tape) tape correspond to the bar's closing time?
- Do receipts signed by the payee support cash payments?
- If servers are employed, how are sales by them controlled?
- Is a third party retained to conduct periodic checks?
- Is the cash reconciled to the register tapes and deposited in the bank intact? If so, at what intervals and by whom?
- Are surveillance cameras used to monitor sales at the register?

b) Inventory Controls

- Who is responsible for purchasing inventory?
- How often are purchases made?
- Are vendors paid with cash, check or money order?
- Are all bottles in the bar purchased from distributors?
- Is the inventory of alcoholic beverages stored in a locked stockroom?
- Who has access to the stockroom?
- Who restocks the bar from the stockroom inventory and at what intervals?
- Is a record maintained of stock removed from the stockroom?
- Are empty (or broken) bottles from the bar exchanged for full bottles removed from the stockroom?
- Who checks incoming merchandise into the stockroom?
- Are the contents of incoming cases verified?
- At what intervals are physical inventories of merchandise in both the stockroom and the bar taken, and by whom?
- Is an automatic liquor dispensing devices used?
- Is the beginning bar inventory, plus stockroom withdrawals, less ending bar inventory periodically extended to retail prices and compared to recorded receipts?
- Does management demand a certain gross profit margin or pour cost?
- Is a written record maintained of complimentary and self consumed drinks?
- If the taxpayer operates two or more locations, is the inventory commingled or transferred between locations?

SELF-CONSUMPTION**0802.45**

A standard allowance for self-consumption of 2% of the taxable cost of goods sold is provided, unless evidence supports a higher allowance. Self-consumption should be discussed at the beginning of the audit and amounts noted on the Bar Fact Sheet (Exhibit 2). Any adjustment exceeding the 2% for self-consumption must be clearly explained in the audit working papers and well documented by the taxpayer. To support self-consumption in excess of the standard 2% allowance, the auditor should include a schedule showing the number and type of drinks (beer, wine, and liquor) in each of the following categories:

- self-consumed by taxpayer and family
- consumed by employees
- treating of customers

Each category should then be totaled to arrive at the total self-consumption allowance. The dollar value of all self-consumed alcohol should be calculated as a percentage of total taxable cost of sales, and the percentage should be noted in the audit working papers. The auditor should make detailed comments in the audit working papers if the amount of audited self-consumption differs from the amount scheduled on the Bar Fact Sheet.

PROFIT AND LOSS STATEMENTS**0802.50**

Operating statements for the business, in conjunction with the income tax returns, should be analyzed for the audit period. If the net profit and return on invested capital is high; it is less likely that recorded sales are understated. On the other hand, if the profit produced by the business does not constitute a reasonable return on the taxpayer's invested time and capital, or the cash flow from the business is insufficient to support the taxpayer's life style, and he or she has no other income, it is possible that recorded sales and net profit are understated. It would be prudent, whenever possible, to compare the recorded sales to observed sales to ensure that the records reflect economic reality.

In analyzing the return on invested capital, the hours worked in the business by the taxpayer and his or her family should be considered. What appears to be a reasonable profit and return on capital may in fact be compensation for long hours of work.

To compute the cash flow for the business, use the following formula:

Net Income:

Add:

- Depreciation
- Increase in accounts payable
- Decrease in inventory

Subtract:

- Capital expenditures
- Decrease in accounts payable
- Increase in inventory

Equals:

Cash Flow from Business Operations

If the cash flow from business operations is insufficient to support the taxpayer's life style, and the taxpayer contends that the difference represents borrowing or income from sources other than sales, then the taxpayer should be requested to substantiate such contentions. The auditor should document such contentions and include any evidence with the audit working papers.

POUR COST PERCENTAGE**0802.52**

The pour cost percentage is an indicator of profit and loss performance because it analyzes the relationship between costs and sales. The pour cost percentage is obtained by dividing the cost of goods sold by sales (portion cost/selling price). Thus, a 20% pour cost means that it costs the taxpayer \$.20 to generate \$1.00 of liquor sales, which translates to a gross profit margin of 80% and a markup on cost of 400%. Since liquor, beer, and wine each vary in their respective sales prices and costs, a pour cost percentage should be calculated separately for each category if the information is available. Many taxpayers will attempt to achieve a certain pour cost percentage, and the auditor should discuss the pour cost percentage with the taxpayer at the beginning of the audit.

Knowing the taxpayer's expected pour cost percentage will assist the auditor in determining the taxpayer's expected markup on liquor, beer, and/or wine sales. Exhibit 12 provides for the conversion from pour cost percentage to profit margin to markup. From this information, the auditor can perform a preliminary analysis to determine whether or not a more detailed review of the taxpayer's records will be necessary.

MARKUPS**0802.55**

A markup is the amount added to cost to obtain the sales price, and generally is referred to in terms of percentages. The percentage of markup is computed by dividing gross profit by cost of goods sold: $G.P./C.G.S. = \% \text{ of M.U.}$ Taxpayers often discuss gross profit in terms of percentages based on sales (e.g., profit margin = $G.P./\text{Sales}$) but seldom discuss the markup on cost. The auditor should make certain the taxpayer understands the difference between the markup on cost and profit margin. (See Exhibit 12).

For example:

Sales =	\$1,000
Cost of Goods Sold =	\$ 400
Gross Profit =	\$ 1,000 - 400 = \$ 600
Markup on Cost =	\$ 600/400 = 150%
Profit Margin =	\$ 600/1,000 = 60%

The achieved markup on the taxpayer's recorded sales should be evaluated in terms of other information which has been developed, such as the data on the Bar Fact Sheet and the auditor's experience with similar businesses, to determine whether the recorded sales are consistent with the established cost of merchandise sold. (See Section 0807.00.)

In a bar audit, consideration must be given to whether the records account for all merchandise that was available for sale. In order for a mark-up analysis to be meaningful, it is imperative for the auditor to verify that the recorded purchases are complete. The auditor should become familiar with the products sold in the establishment and verify that all items are accounted for when reviewing purchase invoices.

To the extent that it is practical to do so, based on available records, the markup should be computed separately for each class of merchandise (beer, distilled spirits, food, etc.), for each year in the audit period rather than on a composite basis for the entire audit period.

BAR SHORT TEST**0802.60**

The Bar Short Test (Exhibit 4) provides a preliminary analysis to determine whether or not a more detailed review of the taxpayer's records will be necessary. A Bar Short Test, Form BOE-1311-A, is provided to assist the auditor in performing a quick test of a taxpayer's markup. The auditor may use BOE-1311-A or an equivalent form at his/her discretion. If a short test is to be performed in a bar audit, the schedule or form used should be retained as a subsidiary schedule to support the mark-up analysis, whether or not a deficiency exists.

The Bar Short Test is divided into six categories: well drinks, call drinks, cocktails, wine/liqueurs, beer domestic and beer premium/microbrew. The auditor should take the most popular drink sold by the establishment from each category and develop a weighted mark-up percentage. Input from the taxpayer or representative(s) is essential to the accuracy of this analysis. The percentage of total purchases may be based upon a discussion with the taxpayer or the representative(s). The auditor may want to perform purchase segregation for a purchase cycle if the expected mark-up percentages differ substantially for each category of drinks. The expected markup should be based upon a supporting schedule that lists the selling price of the drink used from each category and the cost per drink. The reference used for establishing the cost of the drink must be noted on the form. To establish the cost of the drink, the auditor should reference recent purchase invoices.

The mark-up percentages from the Bar Short Test must then be compared to the mark-up percentages achieved based upon the taxpayer's records. The auditor should indicate whether the achieved markup per record is tax included or ex tax, as well as the mark-up percentages developed in the Bar Short Test. The auditor must comment on any differences between the markups and whether or not further analysis is warranted. The auditor should always seek his/her supervisor's guidance if there is uncertainty on whether to proceed with an audit or accept reported sales. An example of a Bar Short Test is provided in Exhibit 13.

TOLERANCE**0802.65**

When performing a mark-up analysis, there are many factors that may potentially affect the results. For example, pour sizes, self-consumption, "happy hour" and entertainment prices all affect a bar's markup. As a result, a tolerance of 10% is used in analyzing bar audit findings on an annualized basis.

The auditor should accept recorded sales of "on sale" distilled spirits, beer and wine if the audit findings disclose a potential under-reporting of less than 10%, unless it can be established by other means that an actual understatement exists. The 10% tolerance applies only to on-premise sales for establishments serving distilled spirits. *It does not apply to establishments selling beer and wine only since the markup for beer and wine can be computed more accurately.* A determination should be issued for the full amount for these types of establishments when reported sales are outside the tolerance.

The 10% tolerance for bar audits can provide assistance to the auditor in applying cut-off techniques when analyzing a short test (see Sections 0405.15 and 0405.35).

ANALYSIS OF AUDIT FINDINGS**0802.70**

The information developed through procedures outlined in the preceding sections should be carefully documented and evaluated by the auditor and included as part of the audit report. If it is concluded that a tax deficiency greater than the tolerance discussed in Section 0802.65 may exist, the auditor should proceed to establish the amount of the deficiency using generally accepted tax auditing procedures (e.g., the mark-up method of computing sales, an analysis of bank deposits, gross profit and net worth analysis, cash flow analysis, etc.).

When an audit approach other than the mark-up method is used, a post audit mark-up analysis should be performed to support the reasonableness of the audit findings. This is done by adding the amount of the deficiency to the reported sales and computing the mark-up percentage on the cost of sales.

Regardless of the audit procedures used by the auditor, if a tax deficiency has been established, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings. This is generally referred to as a reasonableness evaluation. | Alternative methods for supporting audit findings may include an analysis of the taxpayer's net income (Section 0803.15), cash flow analysis, analysis of bank deposits (Section 0405.25), and gross profit and net worth analysis (0406.40), etc.

MARK-UP METHOD OF COMPUTING SALES**0803.00****GENERAL****0803.05**

The Board's authority to impeach the taxpayer's records is authorized by Revenue and Taxation Code section 6481. Specifically, the validity of using the mark-up method of computing sales, when there is a basis for disregarding recorded sales, was upheld by the court in *Maganini v. Quinn*, (1950) 99 Cal. App. 2d 1.

Even though the taxpayer's books and records are comprehensive and in agreement with each other, the Board is not required to accept such evidence as conclusive and may use recognized and standard accounting procedures to establish audited sales. Where the Board establishes a deficiency, the burden of proof is upon the taxpayer to explain any disparity between their books and records and the results of the Board's audit (*Riley B's, Inc. v State Board of Equalization* (1976) 61 Cal. App. 3d 610).

The mark-up method may only be used when there is support that the taxpayer's records are inadequate. If the taxpayer's recorded sales are impeached and sales are established by generally accepted tax auditing procedures (i.e., mark-up method), the auditor must explain why it was necessary to disregard the taxpayer's records. The comments on the back of Form BOE-414-A, under the caption "Books and Records" (Section 0206.36), should explain why it was necessary to disregard the records. *The comments should never indicate that the records were adequate when it was necessary to compute sales by the mark-up method. Such a comment is inconsistent with the use of the mark-up method.*

ACCURACY**0803.10**

The accuracy of the bar mark-up method depends upon the following factors:

- Accuracy of cost of sales
- Accuracy of drink sizes and all selling prices
- Accuracy of all calculations
- Correct weighting of the various types of drinks and other merchandise sold
- Adequacy of tests to determine the markups

REASONABLENESS**0803.15**

When a mark-up analysis indicates that there were unreported sales during the audit period, a reasonableness evaluation must be performed to support the audit findings.

The preferred method for the reasonableness evaluation is an analysis of the taxpayer's *net income* (per income tax returns or financial statements). This will include a schedule showing the deficiency per audit added to the taxpayer's income per financial statements or income tax returns. In the example below, a taxpayer's \$50,000 annual recorded income is added to a hypothetical audit assessment which projects additional annual unrecorded sales of \$150,000. This results in an audited annual income of \$200,000 for the taxpayer.

	<u>1999 Income</u>
Reported Net Income per FITR	\$ 50,000
Add: Unreported Sales per Mark-up Analysis	<u>150,000</u>
Audited Income	<u>\$200,000</u>

The reasonableness of the computed understatement should be evaluated as a whole and as to the amount per month, the amount per day or shift, etc. In this case, we have income of \$200,000 per year, or approximately \$16,667 per month, or \$3,846 per week, etc.

REASONABLENESS**(CONT.) 0803.15**

Consideration should be given to adjustments for unrecorded cash payments, such as unrecorded purchases, employees working “off the books,” etc.

Example:

Reported net income	\$ 20,000
Add: Unreported sales per markup-analysis	100,000
Less: Unreported wages	
Hours open per day	14
Employees needed for staffing	2
Staffing hours required per day	28
Average hourly wage	7
Daily payroll	196
Days open per year	360
Employee payroll	70,560
Recorded wages per FITR	15,000
Unreported wages	55,560
Audited Income	\$ 64,440

The auditor should make specific comments regarding the reasonableness of the audited figures to explain and reinforce the proposed audit assessment. Comments should be based upon the type and size of the business as well as the taxpayer’s lifestyle, growth of assets or reduction of personal debt (e.g., reduction of principal balance of mortgage based on a review of interest claimed on income tax returns).

AUDIT WORKING PAPERS**0803.20**

Audit working papers must include sufficient references so the audit schedules can be traced back into the taxpayer’s records. For example, schedules of purchase invoices for test periods should include the name of the vendor, the invoice date, a description of each item of merchandise on the invoice, the number of units and the purchase price of each type of merchandise (Exhibit 5). When facilities are available, photocopies of the purchase invoices in the test period should be included as support for the purchase segregation.

COMPUTATION OF COST OF SALES**0804.00****GENERAL****0804.05**

To correctly compute the cost of sales, it is necessary that the auditor determine:

- Beginning and ending inventories
- Total purchases
- Adjustments for self-consumed merchandise
- Adjustments for losses (e.g., pilferage)
- Whether mixes and supplies are included in purchases

INVENTORIES**0804.10**

Inventories, if supported by detailed work sheets, may be accepted as correct. If, however, inventories presented are not so supported and there is reason to believe they are estimates, it would be preferable to regard the inventories as being constant. The auditor must include comments in the audit working papers reflecting these types of situations. Inventories should be compared to those reflected in the records and income tax returns of the taxpayer.

TOTAL PURCHASES**0804.15**

In cases where the achieved markups based on the taxpayer's records appear to be reasonable, yet total recorded sales are lower than expected, it is possible that total purchases may have not been recorded (in addition to total sales). When there is reason to believe the purchase records do not properly reflect total purchases, some or all of the following verification should be performed:

- Adjust for changes in accounts payable.
- Examine expense records to determine whether some purchases may have been concealed therein to improve the relationship between recorded purchases and reported sales.
- Annualize the segregated purchases (0807.10) and compare the total to recorded annual purchases. Annualized purchases greater than recorded purchases may indicate that all purchases are not accounted for in the financial records presented. Annualized purchases less than recorded purchases may indicate that not all purchase invoices were provided.
- Analyze the purchasing cycle to determine if vendors arrive at regular intervals.
- Examine current purchase invoices to determine if all brands of liquor on taxpayer's shelves and in inventory are represented on vendors' invoices of liquor purchases.
- Compare vendors' statements with invoices.
- Ensure that items purchased with cash are accounted for in recorded purchase summaries.
- If it appears that purchases may be understated, all liquor distributors in the taxpayer's area should be contacted to obtain a purchase history.
- Consider contacting the Department of Alcohol and Beverage Control or the Bureau of Alcohol, Tobacco, and Firearms to obtain information regarding purchases from non-licensed wholesalers or other violations.
- Review the taxpayer's purchase invoices for purchases of liquor, beer, or wine made at wholesale and warehouse stores.

TOTAL PURCHASES**(CONT.) 0804.15**

The auditor should be aware that the Bureau of Alcohol, Tobacco, and Firearms (ATF) requires every retail dealer who makes sales of distilled spirits, wines, or beer in quantities of 20 wine gallons (75.7 liters) or more to the same person at the same time to prepare and keep a record of each such sale, which shows (1) the date of sale, (2) the name and address of the purchaser, (3) the kind and quantity of each kind of liquor sold, and (4) the serial numbers of all full cases of distilled spirits included in the sale. (27 C.F.R. Section 194.234 (2000).) These records are to be maintained for a period of not less than three years and during this period the records are to be made available at the business premises for inspection and copying by ATF officers. If it appears that the taxpayer is purchasing from a retailer, such as a “warehouse store,” the auditor should contact the “warehouse store” and inquire if these records are available.

QUANTITY DISCOUNTS**0804.25**

The custom of the liquor industry is to periodically allow quantity discounts to retailers. Purchases are ordinarily recorded net of discount. Sufficient testing of overall purchases should be conducted to ensure that such discounted purchase prices are representative of the overall purchasing habits of the taxpayer. If the auditor determines that the sampled discounted purchases are customary or recur on a regular basis, then the auditor should list the discounted purchase price when scheduling purchases for the shelf test. However, if such discounted purchases are not customary or do not recur on a regular basis, then the non-discounted prices should be utilized in the shelf test.

CREDIT REGULATIONS**0804.30**

Business and Professions Code section 25509 states that a wholesaler of alcohol shall charge the retailer 1% of the unpaid balance when the invoice is not paid timely. When a delinquency charge is levied pursuant to this section, any such delinquency charge is an interest charge and should not be included in audited purchases.

SELF-CONSUMED MERCHANDISE OVER-REPORTED**0804.45**

In some instances, taxpayers may report what appears to be an excessive amount of self-consumed merchandise. The auditor should in all cases verify the amounts reported, and if it is determined the amount is excessive, the excess should be restored to the cost of sales for purposes of computing sales by the mark-up method. Comments must be provided in the audit explaining why the information provided in the Bar Fact Sheet regarding self-consumption is different.

Self-consumed merchandise is sometimes over-reported because it is rung up at the retail selling price and included in sales. These amounts should be eliminated from sales and only the cost considered as self-consumed merchandise, where applicable.

PILFERAGE**0804.47**

An allowance for pilferage, also known as “shrinkage,” in the amount of 2% of the cost of goods sold is allowed. Pilferage is an adjustment made for inventory purchases that were not sold due to some type of loss, such as employee theft, customers not paying, free drinks served outside of the bar’s written policy on the “treating of customers,” and spoilage. If the taxpayer does not maintain a written policy on “free drinks” or “treating of customers,” the total number of drinks provided without charge should be considered as self-consumption and not as pilferage. Self-consumption and loss from fire and/or natural disasters are not included in this amount and should be adjusted for separately. The pilferage adjustment is made after an adjustment for self-consumption. The total amount of pilferage allowed should be stated and expressed as a percentage of total taxable purchases in the audit working papers. See Exhibit 6.

PILFERAGE**(CONT.) 0804.47**

Taxpayers claiming pilferage shall be given a standard 2% pilferage allowance, unless evidence supports a higher allowance. Any adjustment exceeding the 2% for pilferage must be clearly explained in the audit working papers and well documented by the taxpayer. Such documentation may include police reports, reports from regularly employed private security guards, private detective agencies, insurance claims, reports from inventory control companies or similar service firms. If the taxpayer provides a well-documented report from an inventory control company, the auditor should consult with the audit supervisor to determine a reasonable percentage of the loss attributable to theft of product as opposed to self-consumption, treating of customers, unrecorded sales and theft of cash. A reasonable percentage should be developed based on any information available to the auditor, such as the information contained on the Bar Fact Sheet, the Statement of Internal Controls, employee records, police reports, or other similar documents or evidence provided by the taxpayer.

ALCOHOLIC BEVERAGES USED IN COOKING**0804.50**

Delete the cost of alcoholic beverages used for cooking meals for resale, if significant. (The amount so used should not be included in the measure of self-consumption as it is for resale.)

MIXES AND SUPPLIES**0804.65**

The mixes and supplies listed below can be recorded either as supplies or as purchases. It is important in calculating the rate of markup that they are treated consistently, i.e., if included in the taxpayer's purchases, they must be included as purchases in the test base. A more accurate result would be obtained, however, if they were excluded from both the test and purchases.

Mixes		Supplies
Ginger Ale/ other lemon lime sodas	Half & Half	Cherries
Cola	*Sweet Vermouth	Olives
Tonic Water	*Dry Vermouth	Cocktail Onions
Soda/Mineral Water	Grenadine Syrup	Lemons
Orange Juice	Sweet & Sour Mix	Oranges
Lemon Juice	Tom Collins Mix	Angostura Bitters
Lime Juice	Margarita Mix	Orange Bitters
Pineapple Juice	Bloody Mary Mix	Tabasco Sauce
Grapefruit Juice	*Triple Sec	Cocktail Napkins
Cranberry Juice	*Blue Curacao	Straws
Tomato Juice		Whipped Cream

*Although Sweet Vermouth, Dry Vermouth, Triple Sec, and Blue Curacao are distilled spirits, they are generally considered as a mix.

COMPUTATION OF SELLING PRICES**0805.00****MIXES SOLD AS BEVERAGES****0805.05**

Almost all bars sell mixes (ginger ale, lemon lime sodas, colas, etc.) as soft drinks. If sales of these mixes are significant, they should be added to total sales of alcoholic beverages computed from the mark-up method. If the taxpayer does not maintain a separate record of such sales, it will be necessary to compute the dollar value of these sales from any information available.

BARS PROVIDING ENTERTAINMENT**0805.10**

Some bars increase their beverage prices when entertainment is provided. The prices charged before and during entertainment should be noted on the Bar Fact Sheet and considered in making the audit. The method for computing the weighted average markup for sales made during periods of entertainment may be computed using the same formula used in Section 0805.15.

When computing achieved markups from the taxpayer's recorded sales, the auditor should exclude entertainment "cover charges" (if any) from recorded sales.

"HAPPY HOUR" & SPECIAL EVENT SALES**0805.15**

Many bars, as a means of increasing patronage, feature a period in the late afternoon or early evening where drinks are sold either at a reduced price or a larger drink is served at the regular price. This period is commonly referred to as "happy hour." Additionally, many bars have "special event" periods (i.e., Superbowl Sunday, Monday Night Football, etc.) that may include draft beer discounted or served in oversized pitchers. The sales during "happy hour" and special events will generally yield a lower markup than regular sales. The auditor must give consideration to this in establishing the overall weighted markup. "Happy hour" and special event sales should be discussed with the taxpayer (i.e., the type and frequency of discounts), and the auditor must fully document this information in the audit working papers.

This situation is the reverse of the entertainment situation (discussed in the previous section) where the prices of drinks are increased during the period of entertainment.

An analysis of the taxpayer's register tapes is the best way to determine the percentage of sales occurring during "happy hour." However, in some cases, an analysis using the register tapes may not be possible. The following is an alternative method for computing the weighted average markup where there are different price structures in place.

Mark-up Percentages (based on cost of goods sold):

	Happy Hour	Regular
Mark-up Percentage on Liquor (ex-tax)	500%	600%
Mark-up Percentage on Beer (ex-tax)	300%	400%

Per Bar Fact Sheet, taxpayer estimates that 25% of total sales are at "happy hour" prices.

Percent of Purchases per 4 Qtr 1999 Purchase Segregation:

Liquor	35%
Beer	65%

Computation of Average Weighted Markup:

Happy Hour (Markup % x % of purchases x estimated % of sales)

Liquor $500\% \times 35\% \times 25\% = .4375$ Beer $300\% \times 65\% \times 25\% = .4875$

Regular

Liquor $600\% \times 35\% \times 75\% = 1.575$ Beer $400\% \times 65\% \times 75\% = 1.950$ Weighted Average Markup 4.45**SALES OF OFF-SALE BEER****0805.20**

Adjustments must be made to account for off-premise sales of beer in quantity (six packs, twelve packs, etc.). These types of sales may be verified from a review of register tapes, discussion with the taxpayer/bartender, and a review of the purchase invoices. Sales of off-sale beer in single bottles/cans or packs at a price less than charged at the bar must be supported by the taxpayer. Often the taxpayer will sell only canned beer off-sale as opposed to bottled beer. Off-sale beer sales should be discussed with the taxpayer/bartender or representative at the beginning of the audit, and the amount and prices so noted on the Bar Fact Sheet.

SALES OF PREMIUM BEER AND KEG CONVERSION CHART**0805.22**

The auditor should be aware that not all one-half kegs contain 15.5 gallons (1,984 ounces) of beer. Certain imported beers and microbrewery beers are sold in kegs, which may be less than 15.5 gallons. Before calculating the proceeds from a keg of beer (Exhibit 10), the auditor should determine the type of beer sold and the correct number of gallons per keg by examining the purchase invoices for a representative period, discussion with the taxpayer/bartender, and/or contacting the beer distributor. The auditor should document this type of information in the audit working papers.

Keg Size Conversion Chart	
Size of Keg	Ounces of Beer
½ bbl. = 15.5 gal	1,984
13.5 gal.	1,728
50 Liter = 13.2 gal	1,690
30 Liter = 7.92	1,014
25 Liter = 7.92 gal.	845
¼ bbl. = 7.75 gal.	992
1/6 bbl. = 5.17 gal.	661
1/8 bbl. = 3.88 gal.	496

PRICE CHANGES DURING AUDIT PERIOD**0805.25**

Changes in prices will affect the markup. The auditor should determine the date and amount of any price changes. Ordinarily, this information can be obtained from discussion with the taxpayer, and in some instances can be supported by cash register tapes, menus, advertisements, etc. Price changes should be documented on the Bar Fact Sheet.

ESTABLISHING SIZE OF DRINK AND PRODUCT LOSSES**0806.00****GENERAL****0806.05**

Determining the size of drinks as accurately as possible cannot be over-emphasized. One or more of the following methods can be used as necessary:

- Glass size
- Count of pour (free hand)
- Measurement of jigger size
- Dispenser gun
- Average pour test and discussion
- Undercover test

The auditor should avoid establishing the pour size based solely on “auditor’s judgement” or “auditor’s knowledge of the industry.” The auditor may accept an average pour size up to 1.5 ounces without testing; however, when the auditor accepts a pour size in excess of 1.5 ounces, the pour size must be supported by detailed audit comments and/or documentation such as the performance of an average pour test or an undercover pour test. In general, a separate pour size must be established for cocktails and exotic drinks. The pour size related to cocktails and exotic drinks should be established using one of the methods discussed below or through discussion with the taxpayer/bartender. *The method used to determine the pour size must be clearly stated in the audit working papers and if an audit conclusion is based on information other than the pour size information contained in the Bar Fact Sheet, such information must be fully explained in the audit working papers.*

GLASS SIZE**0806.10**

The first step in determining any drink size is to obtain the glass size used by the taxpayer for each drink. The Bar Fact Sheet requires the taxpayer to list the different glass sizes (e.g., beer, wine, cocktail, and shot glasses). The glass size used to serve a drink is the starting point to establish the drink size and provides the maximum drink size.

Since most drinks are not filled completely to the top of the glass, one of the following methods, in conjunction with the Bar Fact Sheet, should be used to determine the drink size.

FREE HAND POURING METHOD**0806.15**

Free hand pouring is a method by which liquor is poured directly from the bottle into the glass without using the jigger as a measuring device. To measure the pour size, a bartender will often count the number of seconds in the pour. The accuracy of this method depends upon the bartender and the consistency of the type of spouts used on the various bottles. Experienced bartenders using this method are usually very proficient in consistently pouring the desired amount of liquor. If a bartender is using the free hand pouring method, the auditor should discuss with the bartender what “count” the bartender is using to establish a specific pour size and perform a quick test of the bartender’s method. Information on the pour size established using the free hand pouring method should be documented in the audit working papers.

JIGGER POURING METHOD**0806.20**

The jigger pouring method uses the jigger as a measuring device for the amount of liquor prior to the pour into the glass. However, the auditor should note that although a jigger may be used, some bartenders add a free pour to the drink, a method commonly referred to as “pouring with a tail.”

MEASUREMENT OF SIZE OF JIGGER**0806.25**

This method assumes the size of the jigger represents the size of the drink poured. The jigger size in current use should be determined through discussion with the taxpayer and/or bartenders. This should be verified by examining purchase invoices covering purchases of jiggers and/or by actual measurement with a pharmaceutical graduate.

If the taxpayer contends that larger sized jiggers were used in prior periods, the auditor should require the taxpayer to furnish evidence in support of his or her contention.

AVERAGE POUR TEST**0806.30**

Comprehensive discussion with the taxpayer and/or bartender together with a pour test may be performed to determine the average pour size of drinks. If performed, the average pour test should generally be conducted at the time the Bar Fact Sheet is prepared.

In conducting a pour test, the taxpayer and/or bartender are asked to pour several representative drinks generally using water. When possible, such tests should be done when a full-time bartender is on duty that has been employed for a significant length of time. The sizes of the drinks are then measured with a pharmaceutical graduate and averaged to determine the average pour size. To assist the auditor, the procedure to conduct an average pour test is described in Appendix B.

UNDERCOVER POUR TEST**0806.40**

The prior approval of the District Principal Auditor or Branch Office Supervisor is required for an undercover pour test. The auditor is encouraged to perform an undercover pour test when the taxpayer has indicated on the Bar Fact Sheet (AM section 0802.15) a pour size that exceeds the 1.5 ounces for mixed drinks, over-the-rocks, and straight shots, and the pour size cannot be verified by other means.

When an undercover test is conducted, a complete report must be prepared and included in the audit working papers. This report should include the date and time the test was conducted, the name of the bartender, the approximate number of customers present, the type of drink, how it was measured, and other pertinent information. When possible, such tests should be done when a full-time bartender is on duty that has been employed for a significant length of time. In addition, if possible, the tests should be conducted during a period (i.e., hour) that is most representative of the business activity. This may entail conducting the test after normal work hours.

To assist the auditor, the procedure to conduct an undercover pour test is described in Appendix C. Unless an employee of the Department of Justice or the Department of Alcoholic Beverage Control (ABC) accompanies the auditor(s), the taxpayer or bartender may legitimately refuse to let the alcohol be taken off the premises for testing. The auditor may contact the Department of Justice or ABC to obtain their assistance or information (e.g., reports on any prior undercover tests).

After an undercover test is conducted, the results of the test should be discussed with the taxpayer and/or bartender at the time it is completed. It is important when analyzing the results of the test for the auditor to consider that the pour size may vary according to the type of drink, the proof of the alcohol, and the temperature of the drink. The auditor should also keep an open mind and use good judgment when the taxpayer asserts that their regular pour size is larger than the test results. This may occur when the taxpayer mainly serves regular, repeat customers or there are other influencing variables, such as those discussed in AM section 0802.20.

OVERPOURING AND SPILLAGE FOR LIQUOR**0806.42**

A 12% allowance is given to the extent of total distilled spirits purchased (excludes beer and wine). This allowance is commonly referred to as an “overpouring and spillage allowance.” The “overpouring and spillage allowance” accounts for factors such as overpouring, spillage, waste, and breakage. Any adjustment greater than 12% for the overpouring and spillage allowance must be clearly explained in the audit working papers and well documented by the taxpayer. The tables in Exhibits 7 & 8 incorporate this 12% allowance.

OVERPOURING, SPILLAGE, AND SPOILAGE FOR WINE**0806.43**

A 6% allowance is provided to the extent of total wine purchased. This allowance is commonly referred to as an “overpouring, spillage, and spoilage” allowance, and represents the variations in pour size and wine that has been discarded. Any adjustment greater than 6% for overpouring, spillage, and spoilage must be clearly explained in the audit working papers and well documented by the taxpayer.

ALLOWANCE FOR COCKTAILS, SPECIALTY, AND EXOTIC DRINKS**0806.45**

A “cocktail” is a drink containing two or more distilled spirits combined with a mixer. This differs from a “mixed drink,” which contains only one type of distilled spirits combined with a mixer. Examples of mixed drinks include a gin and tonic, rum and cola, or bourbon and ginger ale (highball). A “shot” is one form of alcohol only, with no mixer. Cocktails usually contain more distilled spirits than mixed drinks or straight shots, and the price charged may be higher. In most cases, a less expensive brand of distilled spirits may be used for cocktails (e.g. well liquor). The following is a list of typical cocktails:

Black Russian	Margarita
Brandy Alexander	Martini
Brave Bull	Pink Squirrel
Grasshopper	Rusty Nail
Golden Cadillac	Stinger
Godfather	Tequila Sunrise
Manhattan	White Russian

Many bars serve specialty or exotic drinks, and the distinction between a specialty drink and an exotic drink depends entirely on the bar where it is served. A specialty or exotic drink is generally determined by the bar glass used and is often served in a hurricane, tulip champagne, pilsner, or zombie glass. A specialty or exotic drink may or may not contain two types of liquor; however, it usually contains more distilled spirits than a mixed drink or straight shot. An exotic drink is generally a blended type drink mixed with fruit juices and containing a garnish (e.g. pineapple and an umbrella). However, a specialty or exotic drink may also be a straight shot of multiple liquors (e.g. tequila popper, Mexican flag, or a B52). The following are examples of additional specialty and/or exotic drinks:

Brass Monkey	Pina Colada
Fuzzy Navel	Planters Punch
Long Island Ice Tea	Zombie
Mai Tai	

ALLOWANCE FOR COCKTAILS, SPECIALTY, AND EXOTIC DRINKS**(CONT.) 0806.45**

If a considerable number of cocktails, specialty, and exotic drinks are sold, an adjustment for these types of drinks must be given in the audit. In many cases, estimates by bartenders or taxpayers may be sufficient to determine if such sales are material to the audit report. The percentage of cocktails, specialty, or exotic drinks may be computed from the cash register tapes, or the inventory of glasses maintained for each type of drink may be used to develop an estimate of the percentage of cocktails, specialty, or exotic drinks served. The auditor should discuss the sales of cocktails, specialty, or exotic drinks with the taxpayer when preparing the Bar Fact Sheet.

In addition to cocktails, it may be necessary on occasion to give consideration to drinks sold “on-the-rocks” (with ice). This is especially important when the taxpayer can establish that the number of ounces served in these drinks exceeds the number of ounces served in mixed drinks. In some bars, there may be a prevalence of drinks sold “on-the-rocks” in which case these sales would have a material effect on the audited amounts. Markups established by audit should be based on the facts at hand. Adjustments for drinks sold “on-the-rocks” should be made only if the auditor’s analysis of the situation indicates that such adjustments are warranted. The reasons for allowing or not allowing adjustments for drinks sold “on-the-rocks” should be noted in audit working papers.

ALLOWANCE FOR “HAPPY HOUR” SALES**0806.50**

Some bars increase the size of drinks during a specific period of the day or lower the prices. The auditor must make allowance for this increased pour of distilled spirits during this period. If “happy hour” sales are separately stated in the records, the average weighted markup may be computed by using the formula in Section 0805.15. If not, the size and number of drinks served must be estimated from the best information obtainable. If necessary, a test may be performed for a period of time to determine the number of “happy hour” sales. This can be done by having the taxpayer total out (also known as “X” out) the register at the beginning and the end of “happy hour.” The percentage of daily sales may be computed and proper weight given in any analysis.

ALLOWANCE FOR “SPECIAL EVENT” SALES**0806.52**

Some bars increase the size of the drink and/or increase or lower the selling prices during “special events” or “promotions.” The auditor must make allowance for any increased pour of distilled spirits and/or the size of the beer served. If special event sales or promotions are separately stated in the records, the average weighted markup may be computed by using the formula in Section 0805.15. If not, the size and number of drinks served must be estimated from the best information available. The auditor should discuss with the taxpayer and/or bartender whether special events or promotions are provided, what type, and how often. If the taxpayer participates in special events or promotions, often the taxpayer will retain advertising, which will assist the auditor in verify the type and frequency of the special event or promotion. The reason for allowing or not allowing an adjustment for special events or promotions should be noted in the audit working papers.

DRAFT BEER-DRINK SIZE AND PRODUCT LOSS**0806.55**

The auditor must be aware of other factors that affect the drink size and product loss for draft beer. The first factor is the “head” of foam served in a glass of beer. Depending on the type of beer and the shape of the glass, the “head” of foam served in a glass of beer can range from one-half to two ounces. The “head” of foam in a glass of beer will offset losses sustained from overpouring, spillage, beer left in the keg, etc.

DRAFT BEER-DRINK SIZE AND PRODUCT LOSS**(CONT. 1) 0806.55**

To quantify the effects of the offset allowed in the “head,” a bar may serve draft beer in a twelve-ounce glass with as much as a two ounce head in each glass. However, the auditor will still use the twelve-ounce glass size to determine the number of drinks served from the keg of beer. In this example, this method amounts to a 20% allowance for losses sustained from overpouring, spillage, beer left in the keg, etc.

However, this method does not account for any loss if there is very little “head” of foam in the glass of beer. To account for draft losses, a standard 10% overpour and spillage allowance is provided. The 10% overpour and spillage allowance accounts for draft beer overpour, spillage, and waste (e.g., inaccessible beer left in the keg, cleaning or flushing keg lines, waste in tapping a new keg or re-tapping, etc.). Self-consumption or pilferage are not included in this allowance as they are adjusted separately and the self-consumption should be noted on the Bar Fact Sheet. This 10% overpour and spillage allowance should *not* be made separately in the audit working papers since the table in Exhibit 10 incorporates this 10% allowance. Therefore, the allowance for overpour and spillage will be the combination of an allowance created by the “head” of foam in each glass and the 10% allowance provided in the table.

In addition to self-consumption (including the treating of customers) and pilferage, the following list of account variables may affect the percentage of draft beer loss. With the exception of the tapping/retapping of a keg and the cleaning of the lines, the loss attributable to the remaining variables can be controlled by the taxpayer through proper installation, temperature and maintenance of the equipment along with the proper training of bar personnel.

- **Tapping and Retapping:** When a keg goes empty (referred to as “blowing a keg”), a certain amount of beer is lost in the line, the down tube and dish. The tapping/re-tapping of a keg can equate to a certain loss per each foot of line, depending on the length and diameter of the line, because the taxpayer must refill the down tube and the beer line in addition to purging off the excess foam. However, kegs tapped in a series lose considerably less beer (i.e., multiple kegs are connected in a series through the draft lines).
- The beer manufacturers require that the draft lines be cleaned on a periodic basis (e.g., once every two weeks). The beer distributors generally make arrangements with the bar owner (taxpayer) to comply with the manufacturer’s requirements on the frequency of the cleanings per month. The amount of beer loss is dependent on the number of cleanings, the length of the lines, and diameter of the beer lines. This information may be confirmed by an examination of the invoices for the beer lines. In addition, the beer distributors recommend that at least one beer per line be discarded after each cleaning to assure that all cleaning/rinse solution has been removed from the line.
- The “first-off-beer” generally refers to the first glass of beer from each line that is poured off each morning (i.e., discarded). The beer industry recommends that each morning at least one glass of beer from each line be poured off to assure the flavors picked up by the beer lying in the line overnight are purged from the system.
- Draft beer must be kept at a constant temperature, ideally in the range of 35 to 39 degrees Fahrenheit. Fluctuations in temperature can affect the pour and create unnecessary foaming. The warmer the beer becomes, the more foam waste. This is a more difficult variable to measure, in that the taxpayer would have to collect the waste and compare it to the total dispensed.

DRAFT BEER-DRINK SIZE AND PRODUCT LOSS**(CONT. 2) 0806.55**

- Pressure in the keg beer system needs to be balanced to the keg box temperature. If the temperature fluctuates during the day, foaming problems can occur causing waste.
- Condition of glassware can effect foaming. The ideal glass is one that has been cleaned with beer compatible soap and prechilled to the same temperature as the beer. If the glass is not prechilled, foaming may occur. If the glass is frosted, it may cause foaming. While the frost may feel smooth to the touch, it is actually very rough and causes the beer to boil (foam).
- Restriction of the line can influence foam. The shorter the beer line, the more restriction, which creates foam. Adding additional beer line will slow down the flow rate of the beer, thereby reducing the agitation, which reduces the foaming.
- The bartender's pouring habits can effect beer loss. Beer taps are typically set to pour a certain amount of beer per second. If the bartender's practice is to run the faucet (tap) for a second or two prior to catching the beer, a quantity of beer can be run down the drain.

Therefore, a taxpayer with numerous beer lines and/or beer lines in excess of the average length (approximately ten feet) may claim that the draft loss is greater than the 10% standard overpour and spillage allowance. An adjustment for additional loss may be provided when the claim is documented and supported by evidence (e.g., invoices on the number, length, and diameter of beer lines, frequency of line cleaning, etc.) from the taxpayer or representative(s). Since the 10% overpour and spillage allowance is incorporated into the table (Exhibit 10), if the taxpayer provides evidence of loss in excess of the 10% standard allowance, the auditor must make an adjustment for the loss already provided for in the table, and state the percentage allowed in the audit working papers. The auditor should clearly explain and document the method used to establish beer loss in excess of the combination of the allowance created by the "head" of foam and the 10% allowance provided in the table.

BREAKAGE ALLOWANCE FOR BOTTLED BEER**0806.60**

A standard 1% allowance is provided to the extent of total bottled beer purchased. This allowance is commonly referred to as a breakage allowance. Any adjustment greater than the 1% allowance must be clearly explained in the audit working papers and well documented by the taxpayer.

COMPUTATION OF MARKUP**0807.00****GENERAL****0807.05**

It is essential that the computed markup of purchases be as accurate as possible. If purchases are segregated by type of merchandise sold, a markup should be computed for each product in the test period. Mark-up percentages should be calculated to two decimal places. This markup can then be applied to each category of purchases for the entire audit period to determine total sales. If purchases are not segregated, it will be necessary to compute a weighted average markup for a test period.

PURCHASE SEGREGATION**0807.10**

The purpose of a purchase segregation is to establish the proportion of purchases made in each beverage category (e.g., liquor, beer, and wine). See Exhibit 5. Whenever possible, the auditor should schedule segregated purchases made over the audit period. If a purchase segregation is not possible, a weighted markup applicable to all purchases should be computed. For bars, the following categories are commonly used to develop a purchase segregation:

Liquors/Liqueurs

- Well drinks
- Call drinks (if applicable)
- Premium drinks

Bottled Beer

- Domestic
- Import/Premium

Draft Beer

- Domestic
- Import/Premium/Microbrew

Wine**Food** (if applicable)

The categories used in performing the purchase segregation should be representative of the taxpayer's business, business records, and purchasing cycle. If for example, no premium liquor is sold, no premium category is needed. However, it is important to differentiate between draft and bottled beer purchases, and to give proper weighting to the percentage of sales of draft beer by the pitcher versus draft beer sold by the glass. Depending on the sophistication of the taxpayer's records, the auditor may expand the above noted purchase segregation categories. The auditor will extend the purchases to retail to determine individual markups for each class of merchandise. A weighted average markup can then be computed that combines the individual markups described above. This weighted average markup will later be applied to the audited cost of sales to establish the measure of audited sales.

In instances where an accurate purchase segregation is available for the entire audit period, individual markups will be computed for each class of merchandise and applied to their respective purchase categories for the entire audit period. If this segregation is not possible, this method should not be used.

If inventories supported by detailed work sheets are available, the markup is to be applied to the audited cost of sales. If, however, there is reason to believe the inventories are estimates, it would be preferable to regard the inventories as being constant and purchases may be considered cost of goods sold. Appropriate audit comments must be made in the working papers.

PURCHASE INVOICES TO BE EXAMINED FOR A REPRESENTATIVE PERIOD 0807.15

Many taxpayers buy merchandise in quantities to secure larger discounts. This may represent normal usage for three or even six months. Sufficient invoices must be examined to be sure a complete purchasing cycle has been covered, and that seasonal variations are considered. If the taxpayer operates more than one business location, the auditor should also verify whether the taxpayer commingles the inventory. To compute the taxpayer's purchasing cycle, the auditor should divide the total purchases by the inventory. For example, assume that a taxpayer has \$400,000 in purchases for a year, and their inventory is \$100,000. The purchasing cycle is four times a year, or three months. The auditor should document the computation and use the purchasing cycle when analyzing purchase invoices.

COMPUTATION OF TOTAL SALES**0808.00****GENERAL****0808.05**

Audited total sales are determined by applying the computed weighted average markup (Section 0805.15) to the audited cost of goods sold (Exhibit 6). A percentage of error is calculated and applied to quarterly recorded total sales for the entire audit period. The auditor should verify whether the audited total sales are tax included or ex tax. This would depend entirely on whether the auditor applied a tax-included or ex-tax markup to the cost of goods sold. If applicable, an adjustment for tax included should be made to the audited measure of tax.

CHANGES THAT AFFECT MARK-UP COMPUTATION**0808.10**

The following changes will affect the weighted mark-up computation:

- Change in the cost of liquor without a corresponding change in the price of drinks
- Change in the size of drinks without a corresponding change in the price of drinks
- Change in the price of drinks without a corresponding change in the cost of liquor and/or change in the size of drink

If any of the above changes are significant, it will be necessary to compute separate weighted mark-ups for periods between changes. If a separate weighted markup cannot be computed, the percentage of error derived from periods believed accurate may be used and applied.

DIFFERENCES BETWEEN REPORTED AND RECORDED SALES**0808.15**

When reported and recorded bar sales are different, the differences must first be analyzed. Differences may exist due to nontaxable revenue derived from pool tables, video games, or other miscellaneous income. Differences resulting from unreported taxable sales should be scheduled and assessed accordingly.

Sales including taxes should never be compared with ex-tax sales.

PROCEDURE WHEN BAR HAS AN OFF-SALE LICENSE**0808.25**

Some bars selling alcoholic beverages by the drink also have an “off-sale” license permitting them to sell beer or wine by the bottle or can. Normally, separate cash registers are used to record the sales in the two departments, and separate recordings are made in the sales journal. In some instances, however, receipts from both departments are commingled, with an informal record being kept of “off-sales.”

The usual audit procedure is to reduce the sales of recorded “off-sales” to cost and consider the balance of the cost of goods sold “on sale,” unless there is evidence to the contrary.

BARS SELLING AN APPRECIABLE AMOUNT OF FOOD**0808.30**

In this type business, food and bar sales are normally segregated. In many of these places, the premises where food is served is separated from the bar, and the common practice is to have one person responsible for the bar operations and another person responsible for the restaurant and kitchen.

If the achieved markup on recorded total sales appears adequate, but the achieved markups for the individual operations are inconsistent, the bar markup too low and the food markup too high, for example; further analysis may disclose that this condition is caused by the restaurant being credited with receipts from alcoholic beverages served to diners. The reverse is true in those instances where the bar markup is high; the restaurant markup is low. Food has been served in the bar and included in the alcoholic beverage sales. In many instances, after an adjustment has been made correcting the sales segregation, both departments show an adequate markup. When auditing business of this type, the auditor should determine whether the sales have been properly segregated and if errors have been made. Recorded bar and restaurant sales should be adjusted for any such difference before markups are calculated and analyzed.

Should it be determined that after the sales have been properly segregated by departments that the markup in one department, for example, the bar, is too low but the recorded food sales indicate an adequate markup of goods purchased, it is proper to apply the markup method to the bar cost of sales to determine audited bar sales. The audited understatement in the bar should then be included in the audit report even though the food sales are accepted as correct. The auditor should make detailed comments in the audit working papers if the restaurant sales are accepted and the bar sales have been established based on the mark-up method.

RESTAURANT AUDITING**0809.00****GENERAL****0809.05**

The audit methodology used by the auditor will depend on the type of restaurant activity, the taxpayer's method of reporting, the records provided by the taxpayer, and/or the records (information) secured by the auditor. The auditor will encounter a variety of businesses such as the following that serve food and beverages;

- Typical sit-down restaurant serving breakfast, lunch, and dinner (e.g. Denny's, Lyons, IHOP, etc.)
- Drive-in restaurant
- Bakery
- Delicatessen
- Bars
- Ice cream parlors
- Coffeehouses
- Caterers and Banquets
- Catering trucks
- Hotels
- Bed and Breakfast Inns
- Student Meals
- Places where admission is charged
- Food carts

When performing an audit of a restaurant combined with other activities, it is imperative that the auditor separates the two activities. This is especially true when a restaurant also operates a bar. All purchases and sales activities must be segregated and analyzed separately when performing a mark-up analysis. A mark-up analysis should be performed and included in the audit working papers for both restaurant and bar sales.

The audit working papers should include a description of the type of restaurant activity as noted in Section 0801.15. A description of the menu items and hours of operation should be included. If available, a photocopy of the menu should also be included.

80/80 RULE**0809.10**

The application of tax to a restaurant's sales of cold food on a "take-out" or "to-go" order will generally depend on whether the establishment qualifies under the 80/80 rule [as provided by Regulation 1603(c)(3)]. If the taxpayer operates multiple locations or more than one type of food operation, each individual location must be considered separately in determining if that location meets the specified criteria. However, combination locations such as a restaurant-bakery or food court location may be considered one operation for purposes of applying the 80/80 rule. Before applying the 80/80 rule, the auditor must first determine if:

More than 80% of the business' gross receipts are from the sale of food products (note: although the sales of alcohol and carbonated beverage are subject to tax, alcohol and carbonated beverages are not considered food products); **and**

More than 80% of the retail sale of food products are taxable because they constitute:

- Sales of food products that are furnished, prepared, or served for consumption at facilities provided by the taxpayer;
- Sales of meals or hot prepared food products; or
- Sales of food products by a "drive-in" (food products sold for immediate consumption at or near a location at which parking facilities are provided primarily for the use of the patrons in consuming the products, even though they may be sold to go).

80/80 RULE**(CONT. 1) 0809.10**

If a business meets both criteria of the 80/80 rule, the sales of cold food on a “to-go” or “take-out” basis, in a form suitable for consumption on the seller’s premises, are subject to tax. However, with supporting documentation such as cash register receipts or sales tickets, the following exceptions may apply:

- The taxpayer may elect to separately account for sales of cold food sold on a “to-go” or “take-out” basis. The sales must be separately accounted for and substantiated by supporting documentation. Without adequate documentation, tax applies to the gross receipts with no deduction for these items.
- Cold food sold in a form *not* suitable for consumption on the premises. A cold food product is not “suitable for consumption on the premises” if it requires further processing by the purchaser, or it is sold in a size not ordinarily consumed by one person. In general, containers larger in size than a pint (excluding milkshakes and similar milk products) are considered to be in a form not suitable for immediate consumption.
- Sales for resale, exempt, or excluded sales, such as to the U.S. Government.

When evaluating sales under the 80/80 rule, a test period of 90 days is recommended. However, a lesser period of time is appropriate if the business activity appears to have little fluctuation from month to month. The auditor should make comments in the audit working papers detailing which periods were selected to test and why the period was representative of the taxpayer’s business operations.

If the test of current sales does not meet the 80-80 criteria, but falls in the range of 75%-80%, the taxpayer should be advised to periodically test sales to insure that the 80-80 criteria is not exceeded, and to apply tax prospectively if the criteria is exceeded. The taxpayer must document and retain the results of any tests performed.

Example — Test for the 80-80 rule:

Hot prepared food products	\$ 85,000
Cold food products (sold in a form suitable for consumption on the seller’s premises):	
Sold to-go	5,000
Sold for consumption on seller’s premises	4,000
Nonfood Sales (alcohol and carbonated beverages)	<u>6,000</u>
Total Sales	<u>\$100,000</u>

In the above example, over 80 percent of the taxpayer’s sales are food sales ($[\$85,000 + \$5,000 + \$4,000] / \$100,000 = 94\%$), and over 80% of the food sales are taxable ($[\$85,000 + \$4,000] / [\$85,000 + \$5,000 + \$4,000] = 95\%$). Do not include alcoholic and carbonated beverages as part of the food product sales. Although their sales are subject to tax, alcoholic and carbonated beverages are not food products. Similarly, food which is furnished in a form not suitable for consumption on the seller’s premises should not be included in the computation. These foods will not become taxable even if the retailer meets the 80-80 criteria, and include such foods as:

- Items not ordinarily consumed because they require further processing, cutting or assembly such as:
 - a whole cold chicken
 - party trays of meats and cheeses
 - hors d’oeuvres prepared and sold to go

80/80 RULE**(CONT. 2) 0809.10**

- Food products typically altered before being consumed
 - a dozen dinner rolls (will be assembled with a meal, cut and buttered)
 - a whole pie or cake (will be cut into individual portions)
- Container size ordinarily not immediately consumed by one person (obviously has more than one serving, and must be subdivided before serving)
 - one quart of salad
 - one quart of ice cream
 - bottled ice cream toppings
 - a loaf of bread
 - a bottle of barbecue sauce

Whether or not the business meets both criteria for the 80/80 rule, sales of hot prepared food products are subject to tax, including hot prepared food sold on a “to-go” or “take-out” basis. A food product is considered a hot food product if it is heated to a temperature above room temperature. A sale of hot prepared food is taxable even if it has cooled by the time of sale since it was intended to be sold as hot food.

The application of tax to the sale of a cold food product depends on the form in which it is sold and where it is to be consumed. When the 80/80 rule does not apply, sales of cold food sold on a “take-out” or “to-go” basis are exempt from tax. However, a sale of a combination of hot and cold foods for a single price is subject to tax. A combination package is two or more items sold together for a single price. The sale of a combination package is taxable if it includes any of the following items:

- A hot prepared food (such as a hot sandwich or hot bakery item)
- A hot beverage (such as coffee, hot chocolate, or tea)

If a combination package sold “to-go” does not include a hot item, it is not taxable (for example a cold sandwich and milk sold together for a single price). All carbonated and alcoholic beverages are taxable, whether sold “to-go” or for consumption on the taxpayer’s premises. If a combination package of a cold food item and a carbonated beverage are sold “to-go” only the sale of the carbonated beverage is taxable. Carbonated beverages include sparkling mineral water and soft drinks.

If a combination of cold food products is sold in an individual **returnable** container, from which the individual serving is intended to be eaten, the sale is subject to tax. The sale is considered a sale of a served meal, which is generally taxable.

For a newly established business, the taxpayer should estimate the percentage of taxable food product sales. If the estimated percentage is less than 80%, records should be maintained detailing the nontaxable sales of food products, and at the end of 90 days the actual percentage should be calculated. If the resulting percentage meets the 80/80 rule criteria for two consecutive quarters, tax will be due on a prospective basis unless sales are separately accounted for by the taxpayer. If the resulting percentage does not meet the criteria, the taxpayer should verify quarterly that the 80/80 rule criteria has not yet been met. The quarterly test of taxable sales should be performed on a continuous basis or until it has been determined the taxpayer meets the criteria for two consecutive quarters. Once the taxable sales meet the established criteria for two consecutive quarters, tax would be due on a prospective basis. Furthermore, once the criteria has been met, the sales remain subject to tax unless there is a significant change in the business operations, or unless the taxpayer elects to separately account for the sales and retains the proper documentation.

EMPLOYEE MEALS**0809.15**

If an employer furnishes a meal to an employee and makes a specific charge for the meal, the charge for the meal is part of gross receipts and subject to tax. A specific charge is made if one or more of the following condition exists:

- The employee pays cash for the meal
- The value of the meal is deducted from the employee's wages
- The employee receives meals in lieu of cash to bring compensation up to legal minimum wage. (i.e., the employee meal is credited apart of the minimum wage: difference between the allowable minimum wage and the actual cash wage paid, if less)
- The employee has the option to receive cash for meals not consumed

If the taxpayer furnishes a meal to an employee and none of the above conditions are present, the meal is considered to have been provided on a complimentary basis and the meal will be treated in the same manner as the taxpayer's self-consumption; i.e., the measure of tax is the cost of the nonfood product items only, such as the carbonated beverages and alcoholic drinks.

Current information on the State minimum wage is available from the local office of the Division of Industrial Welfare, Department of Industrial Relations, State of California. Information on Federal regulations can be secured from the Wage and Hour Division, Department of Labor, U.S. Government.

EMPLOYEE TIPS**0809.20**

No employer shall collect, take, or receive any gratuity or part thereof, paid, given to, or left for an employee by a patron, or deduct any amount from wages due an employee on account of such gratuity, or require an employee to credit the amount, or any part thereof, of such gratuity against and as a part of the wages due the employee from the employer. (Labor Code section 351.) If this prohibition is violated, any amount of such gratuities received by the employer will be considered a part of the gross receipts of the employer and subject to tax.

Optional tips are not included in gross receipts and are not subject to tax.

Mandatory tips, such as those applied by a restaurant when a party exceeds a specific number of patrons, are considered part of gross receipts and subject to tax. Each restaurant may have its own policy with respect to the specific number of patrons necessary before a charge for tipping is mandatory. Ex: "A 17% gratuity will be added to parties of 8 or more."

The auditor should discuss tipping with the taxpayer and if necessary examine the taxpayer's payroll records as verification of the taxpayer's policies.

SELF-CONSUMPTION**0809.25**

An allowance for self-consumption as discussed in Section 0801.25 should always be given in an audit of a restaurant. The amount of self-consumption should be discussed with the taxpayer and include merchandise consumed by the taxpayer, “treating” of customers, and the furnishing of employee meals (if not otherwise taxable). Since the taxpayer is the consumer of all food and beverages that are self-consumed, use tax will apply only to the consumption of those non-food items, such as alcoholic beverages and sodas. A standard allowance for self-consumption of 2% of the cost of taxable goods sold is provided, unless evidence supports a higher allowance. Any adjustment exceeding the 2% for self-consumption must be clearly explained in the audit working papers and well documented by the taxpayer. The amount of self-consumption should be expressed as a percentage of the taxable cost of sales.

PILFERAGE, SPOILAGE, AND WASTE**0809.30**

An allowance for pilferage, also known as “shrinkage,” in the amount of 2% of the cost of goods sold is allowed. Pilferage is an adjustment made for inventory purchases that were not sold due to some type of loss, such as employee theft of merchandise, customers not paying for meals, etc. An allowance for pilferage in excess of 2% may be given if the taxpayer provides evidence such as police reports, insurance claims, reports from inventory control companies, or similar service firms. Pilferage excludes loss due to fire or natural disaster. Documented losses resulting from fire or natural disaster should be addressed separately from the 2% allowed for pilferage. Thefts of cash are more likely to occur in a restaurant than the actual pilferage of the merchandise. However, no adjustment is made for robberies of cash for sales tax purposes because tax is measured by sales. The auditor must express the amount of pilferage as a percentage of the taxable cost of goods sold in the audit working papers.

Spoilage and waste occurs in most restaurants, and the amount of spoilage and waste will depend on the type of restaurant and food served. The auditor should discuss the amount or percentage of spoilage and waste with the taxpayer at the beginning of the audit and document the taxpayer’s information and/or estimates in the audit working papers. If the auditor is going to disregard some or all of the information provided by the taxpayer with respect to spoilage and waste, the reasons must be clearly stated with detailed comments and/or supported by documentation. Any adjustment made by the auditor for spoilage that may appear excessive to those reviewing the audit, should be clearly explained and well documented in the audit working papers. In the audit working papers, the auditor should comment on any adjustment made for spoilage and waste, and express the spoilage and waste as a percentage of the taxable cost of goods sold.

If the mark-up method is used to establish audited taxable sales, the auditor should make a separate adjustment for pilferage and for spoilage. In the audit working papers, the auditor must express the amount of pilferage and spoilage in dollars and as a percentage of the taxable cost of goods sold.

RESTAURANT AUDIT PROCEDURE**0810.00****RECONCILIATION OF RECORDED AND REPORTED SALES****0810.05**

The auditor should conduct a reconciliation between the taxpayer's recorded sales (including the sales tax accrual account) and the reported sales, using the taxpayer's books and records which include the taxpayer's federal income tax returns (FITR's) and profit and loss statements. If differences are noted, the differences should be analyzed and discussed with the taxpayer. Any unexplained differences noted should be well documented. While conducting the reconciliation, the auditor should also calculate and analyze the taxpayer's achieved markup based on recorded sales and reported markups in conjunction with any prior audits conducted on the taxpayer's restaurant and/or with industry standards or averages.

RECONCILIATION OF BANK DEPOSITS**0810.10**

A reconciliation of the taxpayer's bank deposits is also recommended as a preliminary auditing procedure. It should be kept in mind that bank deposits are generally considered tax included, unless it can be shown that the taxpayer did not collect sales tax reimbursement. At the beginning of the audit, the auditor should question the taxpayer with respect to income from non-sales sources. If the taxpayer contends that income is deposited into the bank from non-sales sources, any adjustments should be verified through documentation. The auditor should also analyze the bank deposits for any transfers between accounts, extraordinary, unusual, or recurring deposits.

CREDIT CARD PROJECTION OF SALES**0810.12**

While performing a reconciliation of the bank deposits, the auditor should consider analyzing sales by using the credit card deposit information. Since sales made by credit card are required to be deposited directly into the taxpayer's bank account, the credit card deposits provide a verifiable source of information. Thus, the credit card projection of sales has proven to be an effective audit procedure in establishing total sales. The credit card projection of sales can be used to analyze reported sales, establish audited sales, or provide an alternative method to support the reasonableness of the audit findings based on another auditing approach. To use the credit card projection method, the auditor should pick a representative test period. This can be accomplished either during an observation test or based on a review of daily sales tickets for a test period. For the test period chosen, the auditor should schedule the sales paid by credit card and schedule the total sales. The auditor should then compute a percentage of credit card sales to total sales. Total credit card deposits are scheduled from the bank information for the audit period, then divided by the credit card sales percentage to establish total sales. Total sales will generally be considered tax included, unless it can be shown that the taxpayer did not collect tax reimbursement. Therefore, adjustments for sales tax included, tips, and credit card company withholds should be taken into consideration, if applicable. The following is an example of the credit card projection of sales being used to support the audit findings based on the observation method.

CREDIT CARD PROJECTION OF SALES**(CONT.) 0810.12**

Example:

Percentage of credit card sales:		
Observation test #1	\$627	
Observation test #2	662	
Total ex-tax credit card sales combined observation tests		\$1,289
Total sales observation test #1	1,298	
Total sales observation test #2	1,096	
Total ex-tax sales combined observation tests		2,394
Percentage of credit card sales to total sales		53.84%
Total credit card deposits for audit period, tax inc.	\$ 615,680	
Total credit card deposits, ex tax (\$615,680 / 1.0825)	568,757	
Total audited sales for audit period (\$568,575 / 53.84%)		1,056,385
Total sales reported for audit period, ex tax		864,236
Unreported sales based on credit card deposits		\$ 192,149
Unreported sales based on observation test		175,720
Difference		\$ 16,429

ANALYSIS OF ACHIEVED MARK-UP PERCENTAGES**0810.15**

Many factors may influence the achieved mark-up percentage on recorded total sales. Generally, the achieved mark-up percentage is derived from the cost of goods sold and total sales as indicated on the taxpayer's FITR's or financial statements. Achieved mark-up percentages will vary depending on the type of food sold, the location, and clientele. The auditor will have to determine if the taxpayer's achieved markup on recorded sales is reasonable based on all the information available such as:

- If the restaurant contains a bar
- The taxpayer's method of recording bar and restaurant sales and costs
- Quantity of food sales in the restaurant in comparison to food sold in the bar
- Size of the portions in relation to the sales price of the menu items

The auditor is cautioned to verify the taxpayer's method of recording sales and costs, because bar sales/costs may be commingled with food sales/cost or vice versa. If this occurs, the achieved individual markups on recorded sales may not be representative and the auditor may find it necessary to perform a segregation of sales and/or purchases before the achieved individual mark-up percentages can be computed and analyzed.

Proper weight must be given to the food sales in relation to the establishment, especially if the audit is of a bar that also serves food. As an example, some bars have a full restaurant while others provide a minimal selection of food as a courtesy to bar patrons. The achieved mark-up percentages on recorded sales should be compared to the mark-up percentages based on reported sales, with any differences noted in the audit working papers. If the auditor believes that achieved mark-up percentages need further support, an estimate of sales should be performed based upon a "shelf test" of selected menu items (Section 0810.25).

COMPUTATION OF COST OF SALES**0810.20**

As with any mark-up analysis, one of the most important factors in calculating the markup will be the correct computation of the cost of sales. When the auditor performs the initial analysis of the achieved markup on recorded sales, the auditor generally uses the cost of goods sold as shown on the taxpayer's federal income tax returns or profit and loss statements. If a more detailed analysis is warranted or the auditor is contemplating establishing sales based on the mark-up method, the auditor must determine:

- Beginning and ending inventories (if available)
- Total purchases
- Adjustments for self-consumed merchandise (which includes complimentary meals and hors d'oeuvres)
- Adjustments for pilferage/spoilage
- Whether supplies are included in purchases

The reasonableness of reductions made to purchases when computing cost of sales must be evaluated by the auditor. If the taxpayer's adjustments appear questionable, the taxpayer should be asked to provide documentation, such as order tickets to support complimentary meals. If self-consumption appears excessive, the auditor should prepare a schedule of the quantity and type of food that is taken for any given period. Prices may be obtained from purchase invoices to determine self-consumption or a reasonable estimate developed from available information.

The auditor may find that the taxpayer does not take a physical inventory or estimates the inventory for financial statement purposes. If no adjustment is made for beginning or ending inventory because the information is unavailable or unreliable, the auditor should consider purchases as costs of goods sold and provide detailed comments in the audit working papers.

SHELF TEST**0810.25**

A shelf test is performed to assist the auditor in analyzing the taxpayer's achieved mark-up percentage(s) on recorded sales and/or to develop a weighted markup to establish total sales when the auditor feels that the achieved mark-up percentages are not reasonable (i.e., too low). The auditor should discuss the test in detail with the taxpayer and request the taxpayer's assistance in costing out menu items. The auditor should start by costing out the items that the restaurant sells most (the most popular dishes) including "plate cost" items such as the vegetable, butter, baked potato, and sauces. The most popular dishes may be determined from a discussion with the taxpayer and a review of the quantity of purchases for the primary ingredients. The quantity and ingredients should be obtained for each serving from the taxpayer. The auditor should note the total volume/weight of the ingredients to ensure reasonableness. The quantity of ingredients should be scheduled, with the cost of each derived from purchase invoices. The total cost of an item should be carried forward to a schedule summarizing all menu items in the test. The mark-up percentages should be computed on an individual and aggregate basis to examine consistency. Exhibit 14 provides an example of how to cost out a menu item.

When the use of the mark-up method is impractical, the auditor may establish sales using other generally accepted tax auditing procedures such as, but not limited to, the observation test (0810.30), bank deposit reconciliation (0810.10), or the credit card projection of sales (0810.12). When an audit approach other than the mark-up method is used, a post audit mark-up analysis should be performed to support the reasonableness of the audit findings. Regardless of the audit procedures used by the auditor, if a tax deficiency has been established, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings (i.e., a reasonableness evaluation). Alternative methods for supporting audit findings may include an analysis of the taxpayer's net income (0803.15), analysis of bank deposits (0810.10, 0405.25), credit card projection of sales, or a gross profit and net worth analysis (0406.40).

OBSERVATION (SITE) TEST**0810.30**

An alternative method to support recorded total sales or taxable sales, and/or establish audited total sales or taxable sales is the observation (site) test. A site test is the physical observation and recording of the activity of the business for a specified period of time. Initially, as a tool in analyzing recorded total/taxable sales, the site test should be performed for an entire day if possible. If the site test is used as the basis to establish audited total and/or taxable sales, to ensure the result is representative, the observation test should generally include several days; one of which should be a weekend, if the business is operated on the weekends. If possible, the auditor should avoid conducting the observation test immediately preceding or following a holiday.

In performing an observation test, the day(s) most representative of the average sales day should be used when possible. This day(s) may be chosen based on a review of the cash register tapes, sales tickets, and/or a discussion with the taxpayer. The auditor should request the taxpayer to maintain and provide the cash register tape(s) or sales tickets for the test day(s) for later comparison against the auditor's scheduling of sales. When performing the observation test, the auditor should schedule the sales as they are rung on the register or at the time the sales ticket is written. For purposes of the observation test, if the taxpayer or employee asks the customer if an order for cold food is to be eaten "here" or "to-go" and the customer responds "to-go," the food is served in a condition of "to-go," but subsequent to receiving his/her order consumes a portion of the food at the facilities of the taxpayer, the auditor should regard this sale as a valid sale of cold food sold on a "to-go" basis. The following factors are important in an observation test and should be considered by the auditor. The auditor should provide documentation and/or comments in the audit working papers with respect to:

- | | |
|--|---|
| <ul style="list-style-type: none"> • Days of operation • Hours of operation • Seating capacity (i.e., the number of chairs and tables, and whether the seating capacity has changed during the audit period) • Employees per shift • Number of shifts • Menu/ prices/ special pricing (daily specials and two-for-one coupons) • Banquet room/ catering/ delivery/ take-out and how take-out is rung up • Cash register controls. How many cash registers? Do they ring out the register after each shift? Are multiple people using the same register? Does the taxpayer operate with an open drawer? | <ul style="list-style-type: none"> • Occurrence of cash payouts • How are sales rung up? Are take-out sales, banquet sales, bar sales, etc. recorded differently? • Is tax charged, is tax included in the price, or is no tax charged? • Percentage of credit card sales • Weather conditions. Rainy days may affect establishments with limited seating capacity and increase or decrease the amount of sales sold on a "to go" basis. • Have the business operations changed during the audit period (expanded, contracted, new menu items added or items deleted)? • Have there been any unusual circumstances during the audit period that would affect sales (robberies, fire, and natural disasters)? |
|--|---|

In addition to the comments with respect to the above, to avoid any misunderstanding, confusion, or perhaps the need for further testing, the auditor should state in the audit working papers the criteria that was used in the observation test to establish taxable or exempt sales. In addition, the audit work paper schedule of sales for the observation test should include not only a taxable and exempt column, but if possible should also provide a brief description of the item sold and whether it was sold "to-go" or for consumption at the facilities. The following is a brief example:

OBSERVATION (SITE) TEST

(CONT.) 0810.30

Description	Selling price (ex-tax)	Taxable	Exempt	To-go	Dine-in
Toasted bagel	1.00		1.00	X	
Toasted bagel	1.00	1.00			X
Toasted bagel w/coffee	2.00	2.00 Combination		X	
Toasted bagel w/coffee	2.00		2.00 sold separately	X	
Total	6.00	3.00	3.00		

The results of the test should be reconciled to the taxpayer's records for the day of the test. If differences were noted, the differences should be analyzed and discussed with the taxpayer. The results of the observation test should be extrapolated for a period of time, generally a year, and compared to reported/recorded amounts. However, if the taxpayer's records are not available for a representative period, the percentage of error developed in the test period may be projected to the remainder of the audit period. Consideration should be given to the seasonal nature of the business (if applicable) and any other relevant factors should be clearly explained in the audit working papers.

If a tax deficiency has been established using the observation test, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings (i.e., a reasonableness evaluation).

ESTABLISHING AUDITED TOTAL AND/OR TAXABLE SALES**0810.35**

If the auditor notices a discrepancy between recorded and reported sales based on the initial examination/analysis, and/or the taxpayer's records are not adequate for sales and use tax purposes, the auditor may establish total sales and/or taxable sales based on one or more of the following auditing procedures. Regardless of the audit procedure used by the auditor, if a tax deficiency has been established, an alternative method must be used and documented in the audit working papers to support the reasonableness of the audit findings. This is generally referred to as a reasonableness evaluation (0803.15).

Each of the following methods for establishing audited total and/or taxable sales is described in more detail in Audit Manual Chapter 4, with the exception of the credit card projection of sales (0810.12) and the observation test (Section 0810.30):

- Reconciliation of recorded to reported sales (0406.35)
- Reconciliation of tax accrual account (0405.10)
- Reconciliation of FITR's (0406.50)
- Bank Deposits (0405.25)
- Credit Card Projection of Sales (0810.12)
- Mark-up method (0407.10)
- Net worth analysis/Cost of living analysis (0406.40)
- Observation (Site) Test (0810.30)

SPECIFIC APPLICATION OF TAX**0811.00****DRIVE-INS****0811.05**

Tax applies to sales of food products ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased, even though such products are sold on a “take-out” or “to-go” basis and are actually packaged or wrapped and taken from the premises.

Food products when sold in bulk, i.e., in quantities or in a form not suitable for consumption on the retailer’s premises, are not regarded as ordinarily sold for immediate consumption on or near the location at which parking facilities are provided by the taxpayer.

With the exception of sales of hot prepared food products and sales of cold food under the 80/80 rule, sales of ice cream, doughnuts, and other individual food items in quantities obviously not intended for consumption on the taxpayer’s premises, without eating utensils, trays or dishes and not consumed on the taxpayer’s premises, are exempt from tax. A taxpayer claiming a deduction on account of food sales of this type must support the deduction with complete and detailed records.

FOOD COURTS**0811.10**

Many shopping malls maintain food courts. A food court generally refers to a grouping of small restaurants that share a common area (i.e., eating facilities). The facilities are provided and/or maintained by either the mall operator (management) or the participating restaurants. The taxpayer leases the specific restaurant area from the mall operator generally based on the square footage of its respective restaurant operation, including a portion attributable to the seating area within the food court. In addition, the taxpayer often pays the mall operator additional fees based on a percentage of the taxpayer’s total gross revenue. In addition to reviewing the records provided by the taxpayer, the auditor may also contact the mall operator to secure information on the total gross revenue reported to the mall operator by the taxpayer. The information may be provided on a monthly or yearly basis depending on the records of the mall operator.

Generally, tax applies to sales of food products ordinarily sold for immediate consumption at the food court, since it generally constitutes facilities of the retailer (taxpayer). In regards to sales of cold food “to-go” or on a “take-out” basis, the auditor should review the type of food products sold and apply the result of the 80/80 rule, as provided by Regulation 1603(c)(3), accordingly.

ICE CREAM PARLORS/BAKERIES/COFFEEHOUSES**0811.15**

In auditing an ice-cream parlor, bakery, or coffeehouse it is important for the auditor to first understand the method of reporting used by the taxpayer and to pay specific attention to the type of merchandise being sold and whether facilities are provided. It may be necessary to test for whether the business meets the criteria of the 80/80 rule for the purpose of its sales of cold food “to-go” or on a “take-out” basis. In addition, the auditor should analyze the reported taxable sales ratio in relation to total sales. If the taxable sales ratio is low, the auditor should consider conducting an observation test as described in Section 0810.30.

If the taxpayer makes a sale of a cold food product, which is subsequently heated by the customer in a microwave available for the customer’s use, the sale is not subject to tax as a sale of hot prepared food. However, if the taxpayer heats the cold food product, the sale is taxable as a sale of hot prepared food.

CATERERS AND BANQUETS

There are special factors to consider when auditing a caterer or restaurant that provides banquet facilities. The auditor should make specific comments in the audit working papers addressing any of the following if applicable:

- Charges for serviceware, tables, chairs, etc.
- Charges for coordinator, consultation, and/or designer fees
- Labor charges and preparation charges for the serving of the meals
- Facility charges (room charges)
- Rental equipment, dance floors, stage equipment, props, etc.
- Parking attendants and security guards
- Entertainment
- Mandatory and optional gratuities
- Corkage fees

Many caterers will maintain a job folder for each event. Other documents might include a “Log” book or copies of the computer sheets that list the events occurring on each specific day. A careful review of the contract is essential when auditing a caterer. The contract may contain elements that will not be billed directly to the caterer’s customer, such as “No-Host” cocktails. When a “No-Host” bar is involved, the selling price(s) charged to the end-consumer (i.e., the guest) is generally negotiated between the caterer’s customer and the caterer prior to the event. The auditor may not be able to determine how many drinks were actually served at the event unless the caterer maintains a beverage inventory report for each event. Often, “No-Host” sales will need to be traced to other sales records such as the cash deposits journal or bank deposits.

If a caterer has contracted for an event at a government owned convention facility (e.g., city or county owned), the auditor may consider reviewing the report issued to the government entity in an attempt to establish total sales.

If a caterer has contracted with a specific organization based on a “guaranteed minimum,” e.g., sandwiches, sodas, snacks and candy, and the minimum was reached, the organization may or may not receive a separate billing, and the contract may be the controlling document. If a separate billing is not issued, the receipts may not be recorded in the normal books of account, such as the caterer’s sales journal. Therefore, a review of the cash receipts journal or bank deposits is a recommended auditing procedure.

The auditor should be cautious of timing differences when using bank deposits to establish total or taxable measure (Section 0405.25), because customers may have paid deposits in advance to secure the caterer’s services. In addition, when the caterer provides its services “off-site,” e.g., not in the taxing jurisdiction of the caterer’s physical business location, the auditor should verify that the caterer reported tax based on the rate applicable to where the sale was made.

Tipping may be provided on a mandatory or optional basis. Optional tips are not subject to tax. Mandatory tips are included in gross receipts. Generally, a caterer or a banquet facility will automatically apply a certain gratuity to parties over a certain number of guests; this is a mandatory tip. Often the caterer or banquet facility will apply a mandatory “service charge.” Although the service charges may represent tips, which are later provided to the employees, the service charges are mandatory and are included in gross receipts.

A charge for corkage fees by the caterer or banquet facility is considered a service in connection with a sale and part of taxable gross receipts. Corkage fees remain taxable whether the caterer, banquet facility, or the customer provides the champagne or wine.

CATERING TRUCKS**0811.25**

In general, sales made by catering truck operators are subject to tax. Generally, a catering truck operator makes sales in designated territories (routes) on a regular basis. In conducting an audit on a catering truck operator, it may be necessary to contact the catering truck operator's vendors to secure purchase information (confirmations). Notwithstanding the audit techniques provided in Audit Manual Chapter 4, an alternative audit approach to verifying total or taxable sales is the observation test (Section 0810.30). The auditor would accompany the catering truck operator on the daily route to observe and document sales. The auditor may find that catering truck operators generally do not maintain cash register tapes or guest checks. However, the catering truck operator (taxpayer) should be requested to maintain cash register tapes or daily tickets for the respective test day(s). During the test, the auditor should schedule sales by providing a brief description of the item sold along with the selling price. The auditor should also state in the audit working papers the criteria that was used in the observation test to establish taxable or exempt sales. Auditors have found it convenient at times to copy the catering truck operator's menu with the corresponding prices and then place a tick mark beside each item as it is sold. The auditor should compare audited total and/or taxable sales with the taxpayer's recorded sales for the period(s) tested. Daily sales should be projected to weekly/monthly/quarterly sales for the audit period.

It is important that an observation test is conducted for a representative period. This period should be discussed with the catering truck operator (taxpayer) and documented prior to the testing. Otherwise, the projection of the results of the observation test may not be representative.

FOOD CARTS**0811.30**

For purposes of this section, food carts refer to small self-contained units that are mobile. Food carts typically offer no seating arrangements, compared to restaurants that have full seating facilities. Carts are generally located within a building or on a street or sidewalk. In general, the majority of food cart sales consist of beverages and bakery items, or walk away type food products sold strictly on a "to-go" basis and served in disposable cups or on disposable plates. The taxability of the food and beverage sales is dependent on the type of food being sold and whether facilities are provided.

Sales of hot beverages such as coffee, tea, cocoa or cider are not taxable if sold for a separate price on a "to-go" basis. Similarly, bakery items such as bread, croissants, pastries, muffins, cookies, bagels, and the like are also not taxable if sold on a "to-go" basis. However, when a hot beverage and bakery item are sold for a single price, the sale is taxable.

Sales of carbonated beverages are not considered food products for purposes of the Sales and Use Tax Law. Sales of carbonated beverages and carbonated water are taxable regardless of whether sold "to-go" or consumed at the facilities provided.

Facilities: If the cart is located within a place where common seating is provided for the consumption of food (such as a shopping mall food court or a cafeteria) or is located in a place where admission is charged (such as a county fair) the food sold is generally subject to tax. Similarly, if food items are served in *returnable* containers such as crockery mugs or glass plates, the sale of the food will be subject to tax. The taxpayer should maintain proper documentation for claimed exempt sales of food (i.e., cold food sold to-go or cold food sold in a form not suitable for immediate consumption).

If the taxpayer makes a sale of a cold food product, which is subsequently heated by the customer in a microwave available for the customer's use, the sale is not subject to tax. However, if the taxpayer heats the cold food product, the sale is taxable as a sale of hot prepared food.

STUDENT MEALS**0811.35**

The application of tax to sales of student meals is explained in Regulation 1603(j). Generally at issue in an audit that involves student meals is whether or not the meals were sold by a qualifying group. If a private caterer rather than a qualifying group sold the meals, then the sales may be subject to tax. The auditor should verify through an examination of the records and/or contracts who actually contracted with the caterer to provide the meals to the students and whether the following criteria for exemption have been met:

- The facilities used by the operator to serve the lunches to the students is used by the school for other purposes such as sporting events and other school activities during the remainder of the day;
- The fixtures and equipment used by the operator are owned and maintained by the school; and
- The students purchasing the meals cannot distinguish the operator from the employees of the school.

As provided in the John Chris Mogannam Memorandum Opinion, assuming the response to the three statements above is in the affirmative, then the sale of the meals is regarded as qualifying for the exemption provided in Revenue and Taxation Code section 6363.

PLACES WHERE ADMISSION IS CHARGED**0811.40**

Tax applies to sales of food products when sold within, and for consumption within, a place the entrance to which is subject to an admission charge, during the period when the sales are made with the exception of:

- National and state parks and monuments
- Marinas
- Campgrounds
- Recreational vehicle parks

The auditor should be aware that that the phrase “National and state parks and monuments” does not include city, county, regional, district or private parks.

In addition, the following do not qualify as places where admission is charged:

- Places where admission is based on membership dues that among other things, entitle the member to entrance to a place maintained by the organization;
- Places where admission is based on the use of a student body card (e.g., school auditorium where dance is being held; or
- Places where there is a charge to use the facilities, but no entrance charge is made for spectators (e.g. golf courses or bowling alleys).

Places where admission is charged generally include theatres, sporting and music events, swapmeets, fairs, and amusement parks. It is the taxpayer's responsibility to document the exemption for sales of food products that would not likely be consumed within the place where it was sold. An example of such food products would include cake mixes, spices, boxed recipes, etc. Nonprofit youth organizations or nonprofit parent-teacher organizations are consumers and not retailers of the tangible personal property they sell. The auditor should examine the type of organization and the products being sold before any conclusions on the taxability of the sales are drawn.

SPECIAL FACTORS**0812.00****GENERAL****0812.05**

Consideration must be granted and audit comments must be made in the audit working papers reflecting special factors such as:

- Daily specials
- Discount coupons
- Packaged plans
- Complimentary food and beverages
- Hotels providing coupons

DAILY SPECIALS**0812.10**

In establishing sales, the auditor should take into consideration “daily specials,” if offered by the taxpayer to the patrons. Daily specials generally provide for a specific menu item(s) to be sold for a reduced price or sold in a combination for a reduced price. The auditor should make specific comments in the audit working papers with respect to any adjustments made due to daily specials. The auditor should examine sales ticket or cash register tapes for verification of daily specials and the application of sales tax reimbursement. The auditor should also perform a reconciliation of the sales tax accrual account.

DISCOUNT COUPONS**0812.15**

Certain restaurants promote two-for-one coupons or other discounts or cards that allow the customer to purchase food and/or beverages at a reduced price (e.g. \$4.00 off or 20% off). If the taxpayer does not receive reimbursement from a third party (e.g. a promoter) for the amount of the discount, the measure of tax is the amount received from the customer. If the taxpayer receives any reimbursement from a third party for the discounted amount, the amount received from the third party is also subject to tax and must be included in gross receipts.

When there is no indication that the discount was computed on the selling price exclusive of sales tax reimbursement, it will be presumed that the discount was allowed on the total sales price including sales tax reimbursement. This is usually the case with unit or lump-sum discounts. When there is evidence that the discount was computed by applying a percentage to the selling price exclusive of sales tax reimbursement, the discount will not be allowed as a deduction since the taxpayer has retained excess tax reimbursement. (See also Audit Manual section 0412.10)

The following examples provide for the application of tax to certain situations:

Example A:

A customer provides the taxpayer with a coupon which states, “Buy One Meal Get One of Equal or Lesser Value Free.” The two meals each cost \$15.00. The taxpayer bills the customer \$15.00. The measure of tax is the \$15.00.

Example B:

The same facts as in example A; however one meal is \$15.00 and the other meal is \$10.00. The taxpayer bills the customer \$15.00. The measure of tax is the \$15.00.

Example C:

The customer provides a coupon, which states the holder is to receive 50% off the regular meal price, with a maximum discount of \$4.00. The meal served is valued at \$15.00. The taxpayer bills the customer \$11.00 (\$15.00–\$4.00). The measure of tax is the \$11.00.

DISCOUNT COUPONS**(CONT.) 0812.15****Example D:**

Same fact pattern as in example A. However, the taxpayer bills the customer for both meals totaling \$30. Sales tax reimbursement of \$2.33 is applied (7.75%). The total bill is \$32.33. The taxpayer reduces the bill by the ex-tax price of one meal, \$15.00. The customer pays \$17.33, which represents the ex-tax price of one meal (\$15) and sales tax reimbursement of \$2.33. In this instance, the taxpayer has collected excess tax reimbursement of \$1.16.

The auditor should review the taxpayer's policies and practices with regard to discounted meals and perform a reconciliation of the sales tax accrual account.

PACKAGED PLANS**0812.20****Bed and Breakfast Inns, American Plan or other Similar Plans**

Many Bed and Breakfast establishments offer what is commonly referred to as the "American Plan." The American Plan is generally offered by an establishment, wherein the establishment charges the guest a fixed sum by the day, week, or other period for room and meals combined. If the establishment offers an American Plan or other similar plan, the establishment must make segregation in its records between the charges for the room and the charges for the meals, hot prepared food products, and beverages. In addition, charges for delivering and/or serving the meals, hot prepared food products, and beverages are also included in the measure of tax, whether the charges are separately stated or not. If no segregation is made, the auditor should develop segregation based on the information available.

COMPLIMENTARY FOOD AND BEVERAGES**0812.25**

Lodging establishments which furnish, prepare, and serve complimentary food and beverages to guests in connection with the rental of rooms are consumers and not retailers of such food and beverages when the retail value of the complimentary food and beverages is "incidental" to the room rental service regardless of where within the hotel premises the complimentary food and beverages are served. For complimentary food and beverages to qualify as "incidental" for the current calendar year, the average retail value of the complimentary food and beverage (ARV) furnished for the preceding calendar year must be equal to or less than 10% of the average daily rate (ADR) for that year. Exhibit 15 is provided to assist the auditor in analyzing whether the hotel or similar establishment is the consumer or retailer of the food and beverages.

"Complimentary food and beverages" means food and beverages (including alcoholic and non-alcoholic beverages) which are provided to transient guests on a complimentary basis and:

- No segregation between the charges for the room and the charge for the food and beverages appears on the guests hotel bill; and
- The guest is not given the option to refuse the food and beverage in return for a discounted room rental rate.

The application of tax to hotels and similar establishments providing complimentary food and beverages is explained in Regulation 1603(a). If applying the formula results in the complimentary food and beverages being ten percent or less, such food and beverages are deemed incidental to the lodging, and not subject to sales tax. For example, if the average daily rate for a hotel in 1995 was \$80.00, and the cost of the complimentary food and beverages per occupied room for the same year was \$3.00, the retail value of the food and beverages would be \$6.00 (\$3.00 with 100% markup). Thus, the retail value of the food and beverages is less than ten percent (\$6.00/\$80.00 = 7.5%). The hotel is the consumer of the food and beverages and tax applies to its cost, where appropriate.

COMPLIMENTARY FOOD AND BEVERAGES**(CONT.) 0812.25**

Computing the ADR for Concierge floors, club level, or similar programs: If the hotel provides concierge floors, club levels, or other areas designed to provide for similar programs, the auditor should apply the formula separately with respect to the complimentary food and beverages furnished to the guests who participated in the concierge floors, club level, or similar programs. The auditor should treat the concierge floors, club level, or similar programs as an independent hotel separate and apart from the hotel in which it is operated. To compute the ADR, the formula would include only the “yearly room revenue” and the “yearly number of rooms rented” from these specific rooms.

HOTELS PROVIDING COUPONS**0812.30**

If a hotel provides its guests with coupons or similar documents that are exchanged for complimentary food and beverages that are “incidental” to the room rental service in an area of the hotel where food and beverages are sold on a regular basis to the general public, the hotel will be considered the consumer and not the retailer of the food and beverages if the coupons or other similar documents are non-transferable. Although the coupon must be non-transferable, pursuant to a memorandum to the District Principal Auditors from the Program Planning Manager, dated March 1, 1999, for periods prior to January 9, 1999, the coupon need not identify the guest by name. Effective January 9, 1999, if the coupons or other documents are transferable or the guest is not specifically identified, the food and beverages provided will be considered sold to the guest(s) at fair retail value of similar food sold to the general public. The auditor should review and document the hotel’s policy with respect to such coupons and/or other documentation.

If a hotel issues its guests coupons, which are to be redeemed at restaurants not operated by the respective hotel or lodging establishment, the hotel is the consumer of the food and beverages when the coupons are redeemed by the guests. The restaurant providing the food and beverages is the retailer and tax will apply to the charge by the restaurant to the hotel.

Exhibit 15 is provided to assist the auditor in analyzing whether the hotel or similar establishment is the consumer or retailer of the food and beverages.

AUDIT PROGRAM FOR BARS**APPENDIX A****Audit Objective**

The primary objective of the tax audit is to determine, with the least possible expenditure of time; the accuracy of reported tax. Additionally, tax audits are to provide information and assistance for taxpayers to correctly and efficiently report and pay future tax liabilities.

Preliminary Review

1. Review district file.
2. Review prior audits.
3. Consider an early visit. This may be done before the official contact if there is reason to believe that sales may be understated and should be done only with Supervisor approval. The purpose is to observe the operations of the business: type of drinks, prices, pour, signs, promotions, etc.

Obtain General Facts and Information

1. Meet at business with taxpayer and bar manager, if applicable.
2. Observe the business in operation.
3. Note the type of establishment and clientele. Is it a neighborhood bar, tourist bar, business bar, entertainment bar? (Section 0801.10, 0801.15)
4. How long have employees been there? High turnover? (Section 0801.15)
5. Is the taxpayer actively involved in the business?
6. Prepare Bar Fact Sheet. (Section 0802.15) Know the purpose of the Bar Fact Sheet and verify the facts. Make sure the taxpayer is aware of the purpose of the Bar Fact Sheet.
7. Know glass size. Measure glasses if necessary. (Section 0806.10)
8. Prepare and do meaningful pour tests. (Section 0806.30)
9. Note the methods and devices used to pour drinks. (Section 0806.00)
10. Develop a percentage of drinks sold by type to be used on Form BOE-1131-A, *Bar Short Test Sheet*. (Section 0802.60)

Review Records

Records Available (Section 0801.20)

First, ask the taxpayer to demonstrate the flow of their accounting system and controls from the time a drink is ordered until the sales tax return is prepared. Note who is responsible for each function. Are the following documents available:

1. Sales and use tax returns and worksheets
2. Federal income tax returns
3. Bank statements, deposit worksheets
4. Register tapes
5. Daily recap sheets
6. Cash paid outs
7. Purchase invoices and cancelled checks
8. Documentation for self-consumption
9. Documentation for any income and expenses
10. Documentation to support additional monies received (loans, video games, pool, "cover charges," etc)

AUDIT PROGRAM FOR BARS**(CONT. 1) APPENDIX A**

Cash register tapes can provide information regarding:

- Changes in prices during the audit period (note: price changes are often imposed when the retailer experiences a change in COGS, i.e., change in excise tax on liquor, or the use of a different glass size, and therefore may not be indicative of a change in mark-up percentages achieved)
- Price and volume of “happy hour” sales and other periods where prices may be different
- Volume and percentage of types of drinks sold
- Percentage of credit card sales

Performing the Audit**General**

1. Reconcile reported total sales to FITR, profit & loss statements, etc.
2. Perform sales tax accrual analysis.
3. Review ex-tax purchases of assets and consumable supplies.
4. Review sales of assets.
5. Document internal controls. (*Section 0802.40*)

Testing (*Section 0802.00*)

1. Perform Bar Short Test.
2. Perform quick purchase segregation.
3. Analyze Bar Short Test. (*Section 0802.60*)
4. Make decision if further testing is warranted or accept recorded sales.

Cost of Goods Sold (*Section 0804.00*)

1. Examine cost of goods sold. What is included and what is not?
2. Determine what is paid for by cash vs. check, and verify that both are recorded.
3. Look for evidence of unrecorded purchases. Are all brands in the bar recorded in the purchases? Know what is in the storeroom.
4. Verify that all invoices are recorded. Does the vendor come weekly, bimonthly or monthly? Check that there are invoices recorded on a regular basis.
5. Determine if purchases are segregated by types (beer, wine, etc.).
6. If purchases are not segregated, perform a purchase segregation for a representative period of time. (*Section 0807.10*)
7. Make sure that purchases are recorded net of discounts.
8. Adjust for inventory changes if they can be supported. (*Section 0804.10*)
9. Are all empty/broken bottles exchanged for new ones?
10. Self-consumption (i.e., complimentary and employee drink policy). (*Section 0801.25*)

Total Sales (*Section 0808.00*)

1. Compare reported and recorded sales.
2. Note the number and types of registers in use.
3. Note the number of bar stools and chairs.
4. Determine gross profit structure and net income. Are wages shown and to whom do they belong?
5. Examine register tapes and use them if appropriate for cumulative totals, key breakdown by type or dollar amount, operating hours.
6. Determine who does the banking, purchasing, closing of registers, and recording of daily sales.
7. Examine bank deposits.
8. Determine how sales of mixes and sodas are recorded.
9. Verify "off sales" and sales of quantity packs to go.

Mark-up Test (*Section 0807.00*)

1. Determine representative purchase cycle for the test period. (*Section 0807.15*)
2. Determine percentages of brands sold through discussions with the taxpayer and from examination of records performed above. Perform purchase segregation if needed. (*Section 0807.10*).
3. Refer to and use the Bar Fact Sheet in your detailed markup.
4. Review and/or clarify all the facts obtained from the taxpayer and recorded by you on the Bar Fact Sheet and in the detailed markup.
5. Establish cost of goods sold (net of consumption and allowances not included in Exhibits 7-10.)
6. Establish selling price of drinks.
7. Calculate markup. (*Section 0807.00*)
8. Determine total audited sales by applying calculated markup to COGS (*Section 0808.00*).
9. Develop a percentage of error and apply to reported taxable measure.
10. Analyze potential audit findings for tolerance (*Section 0802.65*).
11. Support audit findings (*Sections 0802.70 and 0803.15*).

Conclusions

1. Project unreported taxable measure based on the percentage of error.
2. Compute material self-consumption not reported.
3. Educate the taxpayer on proper recording and reporting procedures (i.e., self-consumption, internal controls)

AVERAGE POUR TEST PROCEDURES**APPENDIX B****Average Pour Test Procedures**

The average pour test is an informal method of establishing the typical pour size of a drink(s). The average pour test should generally be conducted at the time the Bar Fact Sheet is prepared and performed in the presence of the taxpayer with the assistance of the taxpayer or a bartender who has been employed by the taxpayer for a significant length period of time.

Items Needed:

1. Pitcher or graduate of water
2. Bar glasses, various sizes (Highball, Tall, Rocks, Wine)
3. Work area to conduct test
4. Graduated cylinder(s)
5. Bar ice

Pour Test Steps:

1. Observe the pour size of typical drinks being ordered in the bar.
2. If the bartender pours using a jigger, record the jigger size and measure the contents of the jigger using water and the graduate. If the bartender pours using a jigger and adds a free pour to the drink (pouring with a tail), discuss with the bartender the size of the pour that he/she is attempting to achieve and measure the pour using the graduate. If an automatic pourer (gun) is used, discuss the preset pour and take measurement of pour.
3. If the bartender uses a free pour, discuss with the bartender his/her "count," (generally every second equals approximately $\frac{1}{4}$ ounce of fluid). Fill graduate with more than enough water to pour several drinks. Record beginning level of graduate.
4. Have the bartender line up 2 to 3 glasses on the bar filled with bar ice. Using the graduate full of water, ask bartender to pour 2 to 3 glasses at once over the ice.
5. Determine the amount of water "poured" (beginning level of graduate minus ending level of graduate, divided by the number of drinks (glasses) poured in the test.
6. Repeat test to get a test average.
7. Repeat same steps for other size/type of drinks, as needed.

Comments

If the results from pour test using water appear unrealistic, request that the bartender or taxpayer do a couple pours using alcohol into typical drink(s) glass without any "mix." Take measurement of pour. Compare results with test using water. If both methods produce unrealistic results, the auditor should consider returning for an unannounced undercover pour test. The auditor should record the procedures used, discussions, persons involved, and the test findings in detail in the audit working papers.

UNDERCOVER POUR TEST PROCEDURES**APPENDIX C****Before the Test**

1. Choose three auditors to conduct the test. It is important that at least one of the three auditors has experience in conducting an undercover pour test in audits of bars and restaurants. The auditor assigned to the audit should not participate in the undercover pour test. One auditor will be assigned as the designated driver and the same auditor should also conduct the actual measuring of the pour size. The designated driver should drive the other participating auditors to their respective homes upon completion of the test.
2. Determine the days and hours of the business operations.
3. Determine a representative day and time to conduct the test. Avoid holidays, special events, happy hour, and entertainment hours.
4. When the test is conducted after normal work hours, designate a contact person that the auditors can reach by telephone in case of an emergency, preferably an audit supervisor or the District Principal Auditor.
5. Obtain written approval for the test from the District Principal Auditor or the Branch Office Supervisor. The written approval must identify the date, time and names of the participants who will conduct the undercover pour test.
6. All participants must take both their BOE Identification Card and driver's license with them.
7. Examine the Bar Fact Sheet (AM section 0802.15) to determine the type of drinks sold, and decide beforehand what drinks will be purchased. Drinks are to be ordered straight or mixed with only water.
8. Have all necessary equipment available (see equipment list). Be familiar with the equipment before the test by performing several test runs at the office.
9. Decide beforehand whether the testing will be done at the bar by the auditors or sent to a designated lab for results. However, unless an employee of the Department of Justice or ABC accompanies the auditors, the taxpayer/bartender may legitimately refuse to let the alcohol be taken off the premises for testing. BOE should not remove an alcoholic drink for testing without the taxpayer's consent.
10. It is recommended that the District Administrator or District Principal Auditor contact the District/Branch Administrator or Supervisor of the local ABC office to discuss the specific tests and ensure there are no conflicts between a BOE undercover pour test and any ABC investigation. The administrator or supervisor of the local ABC office can properly advise the BOE whether or not to reschedule the undercover test. The telephone numbers and addresses of ABC district offices are located at <http://www.abc.ca.gov/distmap.html>.
11. It is also recommended that the District Administrator or District Principal Auditor contact the local authorities (law enforcement) of the city or county where the business is located to inform them about the BOE, what BOE auditors do when conducting an undercover pour test, and to obtain a contact person or unit name and number, in case staff encounters a problem while conducting a test.

Equipment

1. 4 to 5 ounce graduate
2. Hydrometer (generally a Van Waters & Rogers Inc. #3417-1)
3. Hydrometer Cylinder: 1 ¼ inches in diameter and 10 inches tall. This is used to float the hydrometer.
4. Thermometer
5. Funnel
6. Temperature Conversion Table
7. Calculator
8. If transporting the container to the lab or delivering the container within 24 hours, the auditor must keep the drinks in a refrigerated container (cooler w/ice or stored in refrigerator).

During the Test

1. Two drinks will generally be purchased, one call and one well drink (a mixed drink, a straight shot or “on-the-rocks,” or a cocktail, if either is claimed to have significant sales volume). When testing is done with a hydrometer, only drinks mixed with water can be ordered. Pay for the drinks. If the assigned designated driver orders a drink (this would be an additional drink); it should be a straight shot and should not be drunk by the Board of Equalization (BOE) employee. This drink may be used as a “control test” to test the proof listed on the liquor bottle if the testing is to be done by a lab; otherwise it may be included as one of the drinks used to test the pour size if the measurement is done at the business location. The other two drinks are to be drunk by the BOE employees.
2. Order an identical round of drinks. Pay for drinks. This second round of drinks is used for testing purposes only.
3. At this point, identify yourself to the bartender. Inform the bartender of your name, where you work, the reason why you are there, and what you intend to do with the drinks (i.e., to test the drinks at the business location or transport the drinks to a lab). If necessary present your BOE identification card.
4. Ask bartender to see the liquor bottles from which the drinks were poured. Note the proof and brand name of each drink being tested.
5. If the taxpayer/bartender has agreed to let the BOE employees remove the drinks from the premises for testing by a lab, pour each drink into a sealable container for transporting to the lab. When transporting the container to the lab or delivering the container to the lab within no more than 24 hours, the BOE employees must keep the container cool by storing it in a refrigerated container (cooler with ice or stored in a refrigerator). Each container submitted for analysis must be properly labeled with all the pertinent information (i.e., the proof of the liquor; if more than one liquor, list each along with ratios, the taxpayer’s name, permit number, brand of liquor, the date sample was obtained, the name of the person obtaining the sample, bartender’s name).
6. If the testing is to be done at the business location, request that the bartender notify the taxpayer and request from the taxpayer/bartender an appropriate location to perform the testing. If possible, avoid using a main room or the bar.
7. Remove any ice from the drinks being tested. Do this by pouring the drink into the graduate, which has a lip for pouring. Pour drink back into glass through a funnel to strain off the ice. Discard the ice. The reason for this is to allow the drink to warm to 60 degrees Fahrenheit. Pour drink back into graduate being careful not to lose liquid.

UNDERCOVER POUR TEST PROCEDURES

(CONT 2) APPENDIX C

8. If the drink was ordered “straight-up,” measure the amount of liquid in the glass. Place thermometer in the measurement glass. After three to five minutes, record the temperature. Remove the thermometer and record the liquid volume total. Use recorded temperature, recorded proof, and conversion table to obtain the correct factor. Multiply the factor by the liquid volume total. Record your answer as the measured pour.
9. If drink was ordered on the rocks, chilled, or shaken, pour tap water into measurement glass until the total amount of liquid equals four to five ounces.
10. Place thermometer in the measurement glass. After three to five minutes, record temperature. A temperature correction factor is used as hydrometers are calibrated at 60 degrees Fahrenheit. Remove the thermometer and record the liquid volume total.
11. Pour the liquid into the graduated cylinder.
12. Place the hydrometer in the cylinder. Verify that the hydrometer is buoyant. If the hydrometer is still touching the base of the cylinder, you will need to add additional water. Water will have no effect on the outcome of the test.
13. Record the hydrometer reading. If the hydrometer is somewhat difficult to read because of the capillary action of the liquid, the reading at the tip of the capillary curve has been found to be most accurate.
14. Use the total test volume of liquid multiplied by the hydrometer reading (or temperature corrected hydrometer reading). Divide by the proof. Record your answer as the measured pour.
15. Provide detailed comments on the results of the pour test with all pertinent information: type of drink(s), method of pour, date, time, proof, bartender’s name, auditors’ names, etc. The auditor may use the “Results of Undercover Pour Test” form or an equivalent form at his or her discretion.
16. Do not forget to clean and dry all equipment.

Formula

$(\text{Total Test Volume} \times \text{Hydrometer Reading}) \div \text{Proof}$

The following is a sample problem, which shows that the temperature of the drink can have a material effect on the pour size.

Hypothetical Facts

Whiskey and water (after ice melt)	5.9 oz.
Temperature of whiskey and water solution	71 degrees F
Hydrometer reading (after ice melt)	18
Proof of whiskey used	80 proof

Calculation of Pour Size without Temperature Correction:

$$(5.9 \text{ oz.} \times 18) \div 80 \text{ proof} = 1.33 \text{ oz. of whiskey}$$

Calculation of Pour Size Adjusting for Temperature

$$(5.9 \text{ oz.} \times 16.1) \div 80 \text{ proof} = 1.18 \text{ oz. of whiskey}$$

Using the conversion tables, a hydrometer reading of 18 would produce a reading of 16.1 at 71 degrees Fahrenheit. Consequently, the reading of 16.1 should be substituted in calculating the drink size.

UNDERCOVER POUR TEST PROCEDURES

(CONT 3) APPENDIX C

Results of Undercover Pour Test

Taxpayer Name:	Account No:
DBA:	Case No:
Address:	Date:
City:	Auditor Name

I. Pre-Test Information:

A. Date and time for test _____

B. Circle type of test desired: Measured Pour Hydrometer

C. Approved by: _____
(DPA or Branch Office Supervisor approval must precede testing)

Type	Brand	Proof	Mix w/ water	Mix w/ ice	Straight	Comments
Well						
Well						
Call						
Call						

II. Test Results:

A. Date and time: _____

B. Name of Bartender(s): _____

C. Type of pouring method: _____

Type	Brand	Proof	Price	Temp	Liquid volume (oz)	Hydrometer Reading	Mix w/ water	Pour size (oz)	Notes
Well									
Well									
Call									
Call									

Test conducted by: _____

Test conducted by: _____

Test conducted by: _____

Table of Exhibits

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Metric Standards and Their U.S. Sizes for Containers.....	Exhibit 11
Pour Cost Conversion Chart.....	Exhibit 12
Bar Short Test — Case Problem	Exhibit 13
Costing Out a Menu Item.....	Exhibit 14
Decision Chart: Complimentary Food and Beverages	Exhibit 15

DESIGNATIONS FOR TYPES OF ABC LICENSES

EXHIBIT 1

Wholesale and Off-Sale Licenses

- 01 Beer Manufacturer
- 02 Wine Grower
- 03 Brandy Manufacturer
- 04 Distilled Spirits Manufacturer
- 05 Distilled Spirits
Manufacturer Agent
- 06 Still
- 07 Rectifier
- 09 Beer & Wine Importer
- 10 Beer & Wine Importer's General
- 11 Brandy Importer
- 12 Distilled Spirits Importer
- 13 Distilled Spirits Importer's General
- 14 Public Warehouse
- 15 Customs Broker
- 16 Wine Broker
- 17 Beer & Wine Wholesaler
- 18 Distilled Spirits Wholesaler
- 19 Industrial Alcohol Dealer
- 20 Off-Sale Beer & Wine
- 21 Off-Sale General
- 22 Wine Blender
- 23 Small Beer Manufacturer
- 24 Distilled Spirits Rectifier's General
- 25 California Brandy Wholesaler
- 26 Out-of-State Beer
Manufacturer Cert.
- 27 California Wine Growers Agent
- 28 Out-of-State Distilled Spirits Shippers
Cert.
- 29 Winegrape Growers Storage License

On-Sale Licenses

- 40 On-Sale Beer
- 41 On-Sale Beer & Wine Eating Place
- 42 On-Sale Beer & Wine Public Premises
- 43 On-Sale Beer & Wine Train
- 44 On-Sale Beer Fishing Party Boat
- 45 On-Sale Beer & Wine Boat
- 47 On-Sale General Eating Place
- 48 On-Sale General Public Premises
- 49 On-Sale General Seasonal
- 50 On-Sale General Club
- 51 Club
- 52 Veteran's Club
- 53 On-Sale General Train
- 54 On-Sale General Boat
- 55 On-Sale General Airplane
- 56 On-Sale General Vessel 1,000 ton
- 57 Special On-Sale General
- 58 Caterer's Permit
- 59 On-Sale Beer & Wine Seasonal
- 60 On-Sale Beer Seasonal
- 61 On-Sale Beer Public Premises
- 62 On-Sale General Dockside,
10,000 ton
- 63 On-Sale Special Beer & Wine,
Hospitals
- 64 Special On-Sale General Theater
- 65 Special On-Sale Beer & Wine,
Symphony
- 66 Controlled Access Cabinet Permit
- 67 Bed & Breakfast Inn
- 68 Portable Bar
- 69 Special On-Sale Beer & Wine Theater
- 70 On-Sale General Restrictive Service
- 75 On-Sale General Brew-Pubs
- 76 On-Sale General Maritime Museum
Association
- 77 Event Permit

BOE-1311-B, BAR FACT SHEET

EXHIBIT 2

Page 1 of 2

BOE-1311-B (S1F) REV. 6 (2-01)

BAR FACT SHEET

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

NAME	ACCOUNT NUMBER	CASE NUMBER
DBA	PERIOD From _____ To _____	
AUDITOR	DATE	

POURING METHOD: ☐ Free Pour ☐ Jigger ☐ Automatic Dispenser

Size of Pour: _____ Standard _____ Long

CONTAINER	GLASS SIZE	POUR SIZE				CONTAINER	GLASS SIZE	POUR SIZE			
		REG	HH	ENT	SE			REG	HH	ENT	SE
Shot Glass						Draft Glass					
Highball Glass						Draft Pitcher					
Rocks Glass						Wine Glass					
Cocktail Glass						Wine Carafe					

SELF-CONSUMED MERCHANDISE:

Self-consumed merchandise is subject to use tax. Use tax is based on the cost of the merchandise consumed, not the retail selling price.

Is self-consumed merchandise reported? ☐ YES ☐ NO

	DISTILLED SPIRITS		BEER		WINE	
	# OF DRINKS PER MONTH	COST PER MONTH	# OF DRINKS PER MONTH	COST PER MONTH	# OF DRINKS PER MONTH	COST PER MONTH
Self-Consumed, Taxpayer						
Self-Consumed, Employee						
Treating of Customers						
Other						
Total Number of Drinks and Cost per Month						

SELLING PRICES PER DRINK

Liquor/Wine	PERIOD:				PERIOD:			
	REGULAR	HAPPY HOUR	ENTERTAINMENT	SPECIAL EVENTS	REGULAR	HAPPY HOUR	ENTERTAINMENT	SPECIAL EVENTS
Well Standard								
Well Other								
Call Standard								
Call Other								
Premium Standard								
Premium Other								
Cocktails								
Cocktails								
Cocktails								
Exotic/Specialty								
Over Rocks								
Wine House								
Wine Premium								
Other								

Beer

Domestic:

Bottled/Canned	oz.							
Off-Sale	oz.							
Draft Glass	oz.							
Draft Glass	oz.							
Draft Pitcher	oz.							
Draft Pitcher	oz.							

Premium/Microbrew:

Bottled/Canned	oz.							
Off-Sale	oz.							
Draft Glass	oz.							
Draft Glass	oz.							
Draft Pitcher	oz.							
Draft Pitcher	oz.							

BARS AND RESTAURANTS

BOE-1311-B, BAR FACT SHEET

EXHIBIT 2
PAGE 2 OF 2

BOE-1311-B (S1B) REV. 6 (2-01)

QUESTIONS ABOUT OPERATIONS FOR THE AUDIT PERIOD _____ TO _____

<p>1. Did glass size change? <input type="checkbox"/> YES <input type="checkbox"/> NO If yes, date of change _____ to what _____</p> <p>2. Did prices change? <input type="checkbox"/> YES <input type="checkbox"/> NO If yes, date of change _____ to what _____</p> <p>3. Automatic liquor dispenser in use? <input type="checkbox"/> YES <input type="checkbox"/> NO a. For what periods? _____ b. What distilled spirits? _____ c. Set for what pour size? _____</p> <p>4. Was there a Happy Hour (HH)? <input type="checkbox"/> YES <input type="checkbox"/> NO a. What days/hours? _____ b. For what periods? _____ c. Estimated percentage of sales _____</p> <p>5. Was entertainment (ENT) provided? <input type="checkbox"/> YES <input type="checkbox"/> NO a. What days/hours? _____ b. For what periods? _____ c. What kind of entertainment? _____ d. Estimated percentage of sales? _____</p> <p>6. Were there special events (SE)? <input type="checkbox"/> YES <input type="checkbox"/> NO a. When/How often? _____ b. For what periods? _____ c. What kind of special event(s)? _____ d. Estimated percentage of sales? _____</p> <p>7. What are the days & hours of operation? _____ day _____ hrs. If days/hours changed, when _____ to what _____</p> <p>8. Estimated percentage of special drink sales to total drink sales: a. Cocktail sales to total sales? _____ b. Exotic/Specialty drinks to total sales? _____ c. Rocks drinks to total sales? _____</p> <p>9. Was there any inventory loss due to: Theft? <input type="checkbox"/> YES <input type="checkbox"/> NO Fire? <input type="checkbox"/> YES <input type="checkbox"/> NO Natural disaster(s)? <input type="checkbox"/> YES <input type="checkbox"/> NO If yes to any of the above, please provide explanation/documentation & amount of loss.</p>	<p>10. Are appropriate tax reimbursement notices displayed per Regulation 1700? <input type="checkbox"/> YES <input type="checkbox"/> NO</p> <p>11. Are cigarettes sold? <input type="checkbox"/> YES <input type="checkbox"/> NO If vending machine, who reports cigarette vending receipts? _____</p> <p>12. Are customers allowed to run a tab? <input type="checkbox"/> YES <input type="checkbox"/> NO If yes, how are charge sales handled? _____ How are bad debts handled? _____</p> <p>13. Are cash register tapes available? <input type="checkbox"/> YES <input type="checkbox"/> NO For what period(s)? _____</p> <p>14. Does the establishment sell food? <input type="checkbox"/> YES <input type="checkbox"/> NO a. If yes, is food sold in separate area? <input type="checkbox"/> YES <input type="checkbox"/> NO b. For what period? _____ c. Are separate records maintained? _____ d. If bar sales are made in restaurant, or restaurant sales are made in bar, how are drink sales and taxes handled? _____</p> <p>15. Are pouring costs (PC) evaluated? <input type="checkbox"/> YES <input type="checkbox"/> NO If yes, by whom/how often? _____ What is the pour cost percentage for the following? _____Liquor _____Wine _____Beer</p> <p>16. Is there a cover charge? <input type="checkbox"/> YES <input type="checkbox"/> NO If yes, when/how much? _____ For what period(s) _____</p> <p>17. How are complimentary drinks accounted for? _____</p> <p>18. Is the bar operated by an absentee taxpayer? _____</p> <p>19. What are the well brands? Whiskey _____ Scotch _____ Gin _____ Vodka _____ Rum _____ Brandy _____ Tequila _____</p> <p>20. List suppliers names: _____</p> <p>21. Is a drink price menu available? <input type="checkbox"/> YES <input type="checkbox"/> NO If yes, please attach.</p> <p>22. Other _____</p>
--	--

PLEASE READ BEFORE SIGNING

The completion of the Bar Fact Sheet is a collaborative effort by the auditor and taxpayer to document the essential information needed to perform an audit of a bar, and **this information may be used to establish audited bar sales**. If someone other than the taxpayer has provided the information, the form should also be reviewed and signed by the taxpayer. The information documented on this form may be modified/ revised by additional information or estimates provided by the taxpayer. If an audit conclusion is based on information other than that contained in this Bar Fact Sheet, such information must be fully documented in the audit working papers and discussed with the taxpayer.

I have reviewed the above information and state that to the best of my knowledge it is accurate and complete.

SIGNATURE OF TAXPAYER OR AUTHORIZED AGENT

DATE



A copy of this form was provided to the taxpayer on _____
(Date)

February 2001

STATEMENT OF INTERNAL CONTROLS

EXHIBIT 3

Page 1 of 2

	Yes	No					
1	<input type="checkbox"/>	<input type="checkbox"/>	Are cash register drawers closed after each sale? Date observed				
2	<input type="checkbox"/>	<input type="checkbox"/>	Do the cash registers print sales tickets? Date observed				
3	<input type="checkbox"/>	<input type="checkbox"/>	Are sales tickets given to customers? Date observed				
4	<input type="checkbox"/>	<input type="checkbox"/>	Is access to the register tapes restricted, and if so, to whom? Name/Title?				
5	<input type="checkbox"/>	<input type="checkbox"/>	Are the cash registers checked out at the end of each shift, and if so, by whom? Name/Title?				
6	<input type="checkbox"/>	<input type="checkbox"/>	If two or more bartenders work simultaneously, do they use the same cash registers? Date observed				
7	<input type="checkbox"/>	<input type="checkbox"/>	Are beginning and ending register transaction numbers compared? If yes, by whom?				
8	<input type="checkbox"/>	<input type="checkbox"/>	Are register tape tears matched? If yes, Name/Title?				
9	<input type="checkbox"/>	<input type="checkbox"/>	Are cash payments supported by receipts signed by the payee? Date verified				
10	<input type="checkbox"/>	<input type="checkbox"/>	If servers are employed, how are sales by them controlled?				
11	<input type="checkbox"/>	<input type="checkbox"/>	Is a third party retained to conduct periodic checks (e.g., inventory, internal controls, etc.)? If yes, what is the frequency of the service?				
			<table border="1"> <tr> <td>Weekly</td> <td>Monthly</td> <td>Quarterly</td> <td>Other</td> </tr> </table>	Weekly	Monthly	Quarterly	Other
Weekly	Monthly	Quarterly	Other				
12	<input type="checkbox"/>	<input type="checkbox"/>	Is the cash reconciled to the register tapes and deposited in the bank intact, and if so, at what intervals and by whom? What intervals?				
			<table border="1"> <tr> <td>Daily</td> <td>Weekly</td> <td>Monthly</td> <td></td> </tr> </table>	Daily	Weekly	Monthly	
Daily	Weekly	Monthly					

BARS AND RESTAURANTS

STATEMENT OF INTERNAL CONTROLS

EXHIBIT 3
PAGE 2 OF 2

	Yes	No	
1			Is the inventory of alcoholic beverages stored in a locked stockroom? If not, specify
2			Who has access to the stockroom? Bartender Servers Shift Manager Others
3			Who restocks the bar from the stockroom inventory and at what intervals? Whom Intervals
4			Is a record maintained of stock removed from the stockroom?
5			Are empty bottles exchanged for full bottles removed from the stockroom?
6			Who checks incoming merchandise into the stockroom? Person Title
7			Are the contents of incoming cases verified? If yes, by whom?
8			At what intervals are physical inventories of merchandise in both the stockroom and the bar taken, and by whom? Weekly Monthly Quarterly Other By whom?
9			Are automatic liquor dispensing devices used? Gun type: Automatic Pourer Other
10			Is beginning bar inventory, plus stockroom withdrawals, less ending bar inventory periodically extended to retail prices and compared to recorded receipts? If yes, how often? By whom?
11			Does management demand a certain gross profit margin? If yes, what margin is desired?
12			Is a written record maintained of complimentary and self consumed drinks? Who verifies the amount self-consumed?
13			Is self consumed reported? If yes, where: Line 1 Line 2
14			Does the taxpayer operate 2 or more locations? Is the inventory commingled or transferred between locations?
SIGNATURE OF TAXPAYER OR AUTHORIZED AGENT			DATE

BOE-1311-A, BAR SHORT TEST

EXHIBIT 4

BOE-1311-A REV. 3 (2-01)
BAR SHORT TEST SHEET

STATE OF CALIFORNIA
 BOARD OF EQUALIZATION

TAXPAYER NAME	ACCOUNT NUMBER	CASE NUMBER
DBA	TELEPHONE NUMBER ()	
AUDITOR	DATE	
RECORDS AT		

INFORMATION NEEDED TO SUPPORT MARKUP COMPUTATIONS OBTAINED FROM

TYPE OF DRINK		SALES PRICE	OZ. SERVED	(A) % OF TOTAL PURCHASES	(B) EXPECTED MARKUP	WEIGHTED MARKUP (A x B)
Well	BRAND			%	%	%
Call	BRAND			%	%	%
Cocktails (2 or more liquors)	BRAND(S)			%	%	%
Wine/Liqueurs	BRAND			%	%	%
Beer - Domestic	BOTTLED/CANNED			%	%	%
	BOTTLED/CANNED OFF-SALE			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT PITCHER			%	%	%
	DRAFT PITCHER			%	%	%
Beer - Premium/ Microbrew	BOTTLED/CANNED			%	%	%
	BOTTLED/CANNED OFF-SALE			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT PITCHER			%	%	%
	DRAFT PITCHER			%	%	%
TOTAL WEIGHTED MARKUP				<input type="checkbox"/> Tax included <input type="checkbox"/> Ex Tax		%

MARKUP PER RECORDS
(Adjusted for Self-Consumed)

☐ Tax included ☐ Ex Tax

YEAR OF	%	YEAR OF	%
YEAR OF	%	AVERAGE	%

SELF-CONSUMED MERCHANDISE

Self-consumed merchandise of \$ _____ / mo. or \$ _____ / yr. excluded before computing the percentage of total purchases and the markup per records.

PURCHASE SEGREGATION

Purchase Segregation
- Distilled Spirits
4th Qtr 1999

12A-3 Page 1 of 2
SR GH 12-345678
S. M.
12/8/1999

A	B	C	D	E	F	G	H	I	J	K	L	M
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Ref	Invoice Date	Invoice Number	Vendor	Brand	Well Fifths	Well 750ml	Well Liters	Other	Call Fifths	Call 750ml	Call Liters	Cost Net of Discounts	Comments
1	10/4/1999	30129	No Wine & Spirits	Grand Mariner								\$65.50	
2	10/4/1999	30129	No Wine & Spirits	Walker Schnapps			6					\$53.55	
3	10/4/1999	30129	No Wine & Spirits	Barton Vodka			36					\$199.60	
4	10/6/1999	1234567	Yang's Market	Ron Antigua Rum			12					\$84.30	
5	10/6/1999	1234567	Yang's Market	Giro Tequila			12					\$83.20	
6	10/6/1999	1234567	Yang's Market	Absolute Vodka							6	\$89.50	
7	10/6/1999	1234567	Yang's Market	Dewars Scotch							1	\$25.60	
8	10/6/1999	1234567	Yang's Market	Johnnie Walker							1	\$25.60	
9	10/1/1999	30284	No Wine & Spirits	Myer's Dark Rum							4	\$84.40	
10	10/1/1999	30284	No Wine & Spirits	Capt Morgan Rum							2	\$28.80	
11	10/1/1999	30284	No Wine & Spirits	Barton Vodka			12					\$65.20	
12	10/14/1999	1696988	Yang's Market	Gallo Chardonnay				24				\$66.80	
13	10/14/1999	1696988	Yang's Market	Hennessy Cognac							1	\$36.65	
14	10/14/1999	1696988	Yang's Market	Segram's Seven							12	\$145.60	
15	10/14/1999	1696988	Yang's Market	Jack Daniels						6		\$82.20	

Total for 4th Qtr 1999	72	38	496	216	27	14	352	\$9,483.13
Less: Wine included in totals				216				\$322.80
Total Distilled Spirits 4 Qtr 99	72	38	196	0	27	14	352	\$9,160.33

Note: A review of purchase invoices indicate that vendors are recorded consistently on a weekly basis.
This exhibit is intended to be one example of a method to perform a purchase segregation. Many different methods exist for performing a purchase segregation.

Copy to Taxpayer

Date: _____

Purchase Segregation

- Beer
4th Qtr 1999

12A-3 Page 2 of 2
SR GH 12-345678
S. M.
12/8/1999

A	B	C	D	E	F	G	H	I	
Ref	Invoice Date	Invoice Number	Vendor	Brand	Number of Cases		Number of 1/2 Barrel Kegs		Cost Net of Discounts
					Regular	Premium	Regular	Premium	
1	10/8/1999	1234	Sahara Distributors	Coors Long Neck 12 oz	15				\$224.60
2	10/8/1999	1234	Sahara Distributors	Coors Lite 12 oz	8				\$116.40
3	10/8/1999	1234	Sahara Distributors	O'Duals 12 oz	6				\$54.80
4	10/8/1999	1234	Sahara Distributors	Sierra Nevada				4	\$280.00
5	10/8/1999	1234	Sahara Distributors	Sam Adams				4	\$320.00
6	10/8/1999	1234	Sahara Distributors	Henieken		6			\$156.00
7	10/11/1999	56789	A.H.B. Distributors	Budweiser 12 oz	30				\$460.60
8	10/11/1999	56789	A.H.B. Distributors	Bud Lite 12 oz	15				\$230.30
9	10/11/1999	56789	A.H.B. Distributors	Michelob 12 oz	6				\$90.00
10	10/11/1999	56789	A.H.B. Distributors	Miller GD 12 oz	6				\$96.00
11	10/15/1999	1468	Sahara Distributors	Coors Long Neck 12 oz	15				\$224.60
12	10/15/1999	1468	Sahara Distributors	Coors Lite 12 oz	8				\$116.40
13	10/15/1999	1468	Sahara Distributors	O'Duals 12 oz	6				\$54.80
14	10/18/1999	57015	A.H.B. Distributors	Budweiser 12 oz	45				\$690.90
15	10/18/1999	57015	A.H.B. Distributors	Bud Lite 12 oz	15				\$230.30
16	10/18/1999	57015	A.H.B. Distributors	Michelob 12 oz	12				\$180.00
17	10/18/1999	57015	A.H.B. Distributors	Miller GD 12 oz	12				\$192.00
18	10/18/1999	57015	A.H.B. Distributors	Bud kegs			10		\$620.00
19	10/18/1999	57015	A.H.B. Distributors	Bud Lite Kegs			10		\$620.00
20									
21									
22									
23									
24									
25									
Total for 4 Qtr 1999					753	255	55	26	\$22,262.70

Notes: Purchase amounts include CRV when applicable.

Copy to Taxpayer

Date: _____

MARKUP ANALYSIS

EXHIBIT 6

MarkUp Analysis

12A-1
SR GH 12-345678
S. M.
12/08/99

	A	B	C	D	E	F	G	H
REF			1997	1998	1999			
1	<per FITR>	Purchases (or CGS)	204,738	234,566	255,898			
2	<per purchase segregation>	Less: Supplies	2,047	2,346	2,559			
3	<per Bar Fact Sheet>	Less:Self-Consumption	1,500	1,500	1,500			
4	(L1-2-3)	Adjusted Purchases	201,191	230,720	251,839			
5	(L4*1%)	Less: 1% Pilferage	2,012	2,307	2,518			
6	(L4-5)	Cost of Sales	199,179	228,413	249,321			
7	<12A-2>	Weighted MarkUp (+100%)	389.00%	389.00%	389.00%			
8								
9	(L6*7)	Audited Taxable Sales (ex-tax)	774,806	888,527	969,859			
10	<per 414>	Reported Taxable Sales	541,233	626,254	702,365			
11	(L9-10)	Difference	233,573	262,273	267,494			
12								
13	(L11/10)	Percentage of Error	43.16%	41.88%	38.08%			
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								

Note: The percentage of error, if any, should be applied to each reporting period.

Copy to Taxpayer

Date: _____

AUDIT MANUAL

**PROCEEDS FROM SALES FROM ONE
750ML BOTTLE OF DISTILLED SPIRITS**

EXHIBIT 7

Pour Size - in Ounces													
	3/4	7/8	1	1 1/8	1 1/4	1 3/8	1 1/2	1 5/8	1 3/4	1 7/8	2	2 1/8	2 1/4
Drinks Per Bottle	33.81	28.98	25.36	22.54	20.29	18.44	16.91	15.61	14.49	13.53	12.68	11.93	11.27
*12% Allowance	4.06	3.48	3.04	2.70	2.43	2.21	2.03	1.87	1.74	1.62	1.52	1.43	1.35
Net Drinks	29.75	25.50	22.32	19.84	17.86	16.23	14.88	13.74	12.75	11.91	11.16	10.50	9.92
Price per Drink	Proceeds From Sales												
1.00	29.75	25.50	22.32	19.84	17.86	16.23	14.88	13.74	12.75	11.91	11.16	10.50	9.92
1.25	37.19	31.88	27.90	24.80	22.33	20.29	18.60	17.18	15.94	14.89	13.95	13.13	12.40
1.50	44.63	38.25	33.48	29.76	26.79	24.35	22.32	20.61	19.13	17.87	16.74	15.75	14.88
1.75	52.06	44.63	39.06	34.72	31.26	28.40	26.04	24.05	22.31	20.84	19.53	18.38	17.36
2.00	59.50	51.00	44.64	39.68	35.72	32.46	29.76	27.48	25.50	23.82	22.32	21.00	19.84
2.25	66.94	57.38	50.22	44.64	40.19	36.52	33.48	30.92	28.69	26.80	25.11	23.63	22.32
2.50	74.38	63.75	55.80	49.60	44.65	40.58	37.20	34.35	31.88	29.78	27.90	26.25	24.80
2.75	81.81	70.13	61.38	54.56	49.12	44.63	40.92	37.79	35.06	32.75	30.69	28.88	27.28
3.00	89.25	76.50	66.96	59.52	53.58	48.69	44.64	41.22	38.25	35.73	33.48	31.50	29.76
3.25	96.69	82.88	72.54	64.48	58.05	52.75	48.36	44.66	41.44	38.71	36.27	34.13	32.24
3.50	104.13	89.25	78.12	69.44	62.51	56.81	52.08	48.09	44.63	41.69	39.06	36.75	34.72
3.75	111.56	95.63	83.70	74.40	66.98	60.86	55.80	51.53	47.81	44.66	41.85	39.38	37.20
4.00	119.00	102.00	89.28	79.36	71.44	64.92	59.52	54.96	51.00	47.64	44.64	42.00	39.68
4.25	126.44	108.38	94.86	84.32	75.91	68.98	63.24	58.40	54.19	50.62	47.43	44.63	42.16
4.50	133.88	114.75	100.44	89.28	80.37	73.04	66.96	61.83	57.38	53.60	50.22	47.25	44.64
4.75	141.31	121.13	106.02	94.24	84.84	77.09	70.68	65.27	60.56	56.57	53.01	49.88	47.12
5.00	148.75	127.50	111.60	99.20	89.30	81.15	74.40	68.70	63.75	59.55	55.80	52.50	49.60
5.25	156.19	133.88	117.18	104.16	93.77	85.21	78.12	72.14	66.94	62.53	58.59	55.13	52.08
5.50	163.63	140.25	122.76	109.12	98.23	89.27	81.84	75.57	70.13	65.51	61.38	57.75	54.56
5.75	171.06	146.63	128.34	114.08	102.70	93.32	85.56	79.01	73.31	68.48	64.17	60.38	57.04
6.00	178.50	153.00	133.92	119.04	107.16	97.38	89.28	82.44	76.50	71.46	66.96	63.00	59.52
6.25	185.94	159.38	139.50	124.00	111.63	101.44	93.00	85.88	79.69	74.44	69.75	65.63	62.00
6.50	193.38	165.75	145.08	128.96	116.09	105.50	96.72	89.31	82.88	77.42	72.54	68.25	64.48
6.75	200.81	172.13	150.66	133.92	120.56	109.55	100.44	92.75	86.06	80.39	75.33	70.88	66.96
7.00	208.25	178.50	156.24	138.88	125.02	113.61	104.16	96.18	89.25	83.37	78.12	73.50	69.44

* The 12% allowance accounts for overpouring, spillage, waste, and breakage.

BARS AND RESTAURANTS

**PROCEEDS FROM SALES FROM ONE
LITER BOTTLE OF DISTILLED SPIRITS**

EXHIBIT 8

Pour Size - in Ounces													
	3/4	7/8	1	1 1/8	1 1/4	1 3/8	1 1/2	1 5/8	1 3/4	1 7/8	2	2 1/8	2 1/4
Drinks Per Bottle	45.09	38.65	33.81	30.06	27.05	24.59	22.54	20.81	19.32	18.03	16.91	15.91	15.03
*12% Allowance	5.41	4.64	4.06	3.61	3.25	2.95	2.70	2.50	2.32	2.16	2.03	1.91	1.80
Net Drinks	39.68	34.01	29.75	26.45	23.80	21.64	19.84	18.31	17.00	15.87	14.88	14.00	13.23
Price per Drink	Proceeds From Sales												
1.00	39.68	34.01	29.75	26.45	23.80	21.64	19.84	18.31	17.00	15.87	14.88	14.00	13.23
1.25	49.60	42.51	37.19	33.06	29.75	27.05	24.80	22.89	21.25	19.84	18.60	17.50	16.54
1.50	59.52	51.02	44.63	39.68	35.70	32.46	29.76	27.47	25.50	23.81	22.32	21.00	19.85
1.75	69.44	59.52	52.06	46.29	41.65	37.87	34.72	32.04	29.75	27.77	26.04	24.50	23.15
2.00	79.36	68.02	59.50	52.90	47.60	43.28	39.68	36.62	34.00	31.74	29.76	28.00	26.46
2.25	89.28	76.52	66.94	59.51	53.55	48.69	44.64	41.20	38.25	35.71	33.48	31.50	29.77
2.50	99.20	85.03	74.38	66.13	59.50	54.10	49.60	45.78	42.50	39.68	37.20	35.00	33.08
2.75	109.12	93.53	81.81	72.74	65.45	59.51	54.56	50.35	46.75	43.64	40.92	38.50	36.38
3.00	119.04	102.03	89.25	79.35	71.40	64.92	59.52	54.93	51.00	47.61	44.64	42.00	39.69
3.25	128.96	110.53	96.69	85.96	77.35	70.33	64.48	59.51	55.25	51.58	48.36	45.50	43.00
3.50	138.88	119.04	104.13	92.58	83.30	75.74	69.44	64.09	59.50	55.55	52.08	49.00	46.31
3.75	148.80	127.54	111.56	99.19	89.25	81.15	74.40	68.66	63.75	59.51	55.80	52.50	49.61
4.00	158.72	136.04	119.00	105.80	95.20	86.56	79.36	73.24	68.00	63.48	59.52	56.00	52.92
4.25	168.64	144.54	126.44	112.41	101.15	91.97	84.32	77.82	72.25	67.45	63.24	59.50	56.23
4.50	178.56	153.05	133.88	119.03	107.10	97.38	89.28	82.40	76.50	71.42	66.96	63.00	59.54
4.75	188.48	161.55	141.31	125.64	113.05	102.79	94.24	86.97	80.75	75.38	70.68	66.50	62.84
5.00	198.40	170.05	148.75	132.25	119.00	108.20	99.20	91.55	85.00	79.35	74.40	70.00	66.15
5.25	208.32	178.55	156.19	138.86	124.95	113.61	104.16	96.13	89.25	83.32	78.12	73.50	69.46
5.50	218.24	187.06	163.63	145.48	130.90	119.02	109.12	100.71	93.50	87.29	81.84	77.00	72.77
5.75	228.16	195.56	171.06	152.09	136.85	124.43	114.08	105.28	97.75	91.25	85.56	80.50	76.07
6.00	238.08	204.06	178.50	158.70	142.80	129.84	119.04	109.86	102.00	95.22	89.28	84.00	79.38
6.25	248.00	212.56	185.94	165.31	148.75	135.25	124.00	114.44	106.25	99.19	93.00	87.50	82.69
6.50	257.92	221.07	193.38	171.93	154.70	140.66	128.96	119.02	110.50	103.16	96.72	91.00	86.00
6.75	267.84	229.57	200.81	178.54	160.65	146.07	133.92	123.59	114.75	107.12	100.44	94.50	89.30
7.00	277.76	238.07	208.25	185.15	166.60	151.48	138.88	128.17	119.00	111.09	104.16	98.00	92.61

* The 12% allowance accounts for overpouring, spillage, waste, and breakage

PROCEEDS FROM SALES OF BOTTLED BEER

EXHIBIT 9

Price per Bottle	Anticipated Proceeds From Sale of Bottled Beer			
	Number of Bottles Per Case			
	12	18	24	36
1.00	12.00	18.00	24.00	36.00
1.25	15.00	22.50	30.00	45.00
1.50	18.00	27.00	36.00	54.00
1.75	21.00	31.50	42.00	63.00
2.00	24.00	36.00	48.00	72.00
2.25	27.00	40.50	54.00	81.00
2.50	30.00	45.00	60.00	90.00
2.75	33.00	49.50	66.00	99.00
3.00	36.00	54.00	72.00	108.00
3.25	39.00	58.50	78.00	117.00
3.50	42.00	63.00	84.00	126.00
3.75	45.00	67.50	90.00	135.00
4.00	48.00	72.00	96.00	144.00
4.25	51.00	76.50	102.00	153.00
4.50	54.00	81.00	108.00	162.00
4.75	57.00	85.50	114.00	171.00
5.00	60.00	90.00	120.00	180.00
5.25	63.00	94.50	126.00	189.00
5.50	66.00	99.00	132.00	198.00
5.75	69.00	103.50	138.00	207.00
6.00	72.00	108.00	144.00	216.00
6.25	75.00	112.50	150.00	225.00
6.50	78.00	117.00	156.00	234.00
6.75	81.00	121.50	162.00	243.00
7.00	84.00	126.00	168.00	252.00

Note: A standard 1% breakage allowance based on the cost of total bottled beer purchased should be applied. This 1% should be adjusted separately in the audit working papers as it is not incorporated into the above table.

BARS AND RESTAURANTS

PROCEEDS FROM SALES OF DRAFT BEER

EXHIBIT 10

Anticipated Proceeds From Sale of One Half (1/2) Keg (1,984 ounces) of Draft Beer											
Size of Glass (oz)	6	8	10	12	14	16	18	20	22	24	32
Number of Drinks	330.67	248.00	198.40	165.33	141.71	124.00	110.22	99.20	90.18	82.67	62.00
*10% overpour & spillage	33.07	24.80	19.84	16.53	14.17	12.40	11.02	9.92	9.02	8.27	6.20
Net Drinks	297.60	223.20	178.56	148.80	127.54	111.60	99.20	89.28	81.16	74.40	55.80
Price per Drink	Proceeds From Sales										
1.00	297.60	223.20	178.56	148.80	127.54	111.60	99.20	89.28	81.16	74.40	55.80
1.25	372.00	279.00	223.20	186.00	159.43	139.50	124.00	111.60	101.45	93.00	69.75
1.50	446.40	334.80	267.84	223.20	191.31	167.40	148.80	133.92	121.74	111.60	83.70
1.75	520.80	390.60	312.48	260.40	223.20	195.30	173.60	156.24	142.03	130.19	97.65
2.00	595.20	446.40	357.12	297.60	255.08	223.20	198.40	178.56	162.32	148.79	111.60
2.25	669.60	502.20	401.76	334.80	286.97	251.10	223.20	200.88	182.61	167.39	125.55
2.50	744.00	558.00	446.40	372.00	318.85	279.00	248.00	223.20	202.90	185.99	139.50
2.75	818.40	613.80	491.04	409.20	350.74	306.90	272.80	245.52	223.20	204.59	153.45
3.00	892.80	669.60	535.68	446.40	382.62	334.80	297.60	267.84	243.49	223.19	167.40
3.25	967.20	725.40	580.32	483.60	414.51	362.70	322.40	290.16	263.78	241.79	181.35
3.50	1,041.60	781.20	624.96	520.80	446.39	390.60	347.20	312.48	284.07	260.39	195.30
3.75	1,116.00	837.00	669.60	558.00	478.28	418.50	372.00	334.80	304.36	278.99	209.25
4.00	1,190.40	892.80	714.24	595.20	510.16	446.40	396.80	357.12	324.65	297.59	223.20
4.25	1,264.80	948.60	758.88	632.40	542.05	474.30	421.60	379.44	344.94	316.19	237.15
4.50	1,339.20	1,004.40	803.52	669.60	573.93	502.20	446.40	401.76	365.23	334.79	251.10
4.75	1,413.60	1,060.20	848.16	706.80	605.82	530.10	471.20	424.08	385.52	353.38	265.05
5.00	1,488.00	1,116.00	892.80	744.00	637.70	558.00	496.00	446.40	405.81	371.98	279.00
5.25	1,562.40	1,171.80	937.44	781.20	669.59	585.90	520.80	468.72	426.10	390.58	292.95
5.50	1,636.80	1,227.60	982.08	818.40	701.47	613.80	545.60	491.04	446.39	409.18	306.90
5.75	1,711.20	1,283.40	1,026.72	855.60	733.36	641.70	570.40	513.36	466.68	427.78	320.85
6.00	1,785.60	1,339.20	1,071.36	892.80	765.24	669.60	595.20	535.68	486.97	446.38	334.80
6.25	1,860.00	1,395.00	1,116.00	930.00	797.13	697.50	620.00	558.00	507.26	464.98	348.75
6.50	1,934.40	1,450.80	1,160.64	967.20	829.01	725.40	644.80	580.32	527.55	483.58	362.70
6.75	2,008.80	1,506.60	1,205.28	1,004.40	860.90	753.30	669.60	602.64	547.84	502.18	376.65
7.00	2,083.20	1,562.40	1,249.92	1,041.60	892.78	781.20	694.40	624.96	568.13	520.78	390.60

*The 10% allowance consists of overpour, spillage, and waste (e.g., inaccessible beer left in keg, cleaning lines, waste in taping a new keg, etc.). Claims for amounts greater than 10% must be clearly explained and well documented.

Wine Metric Standards

Metric Size	Fluid Ounces	U.S. Size Near Equivalent	Fluid Ounces	Bottles Per Case
3 Liters	101	Jeroboam	102.4	4
1.5 Liters	50.7	Magnum	51.2	6
1 Liter	33.8	Quart	32	12
750 Milliliters	25.4	Fifth	25.6	12
375 Milliliters	12.7	Tenth	12.8	24
187 Milliliters	6.3	Split	6.4	48
100 Milliliters	3.4	Miniature	2	60

There are no new metric equivalents for wines in the following U.S. sizes:

U.S. Size	Fluid Ounces
One Gallon	128
Half Gallon	64
Pint	16

Distilled Spirits Metric Standards

Metric Size	Fluid Ounces	U.S. Size Near Equivalent	Fluid Ounces	Bottles Per Case
1.75 Liters	59.2	1/2 Gallon	64	6
1 Liter	33.8	Quart	32	12
750 Milliliters	25.4	Fifth	25.6	12
500 Milliliters	16.9	Pint	16	24
200 Milliliters	6.8	1/2 Pint	8	48
50 Milliliters	1.7	Miniature	1.6	120

POUR COST CONVERSION CHART

EXHIBIT 12

Pour Cost Percentage	Gross Profit Margin	Mark-up Percentage
10	90	900.00%
11	89	809.09%
12	88	733.33%
13	87	669.23%
14	86	614.29%
15	85	566.67%
16	84	525.00%
17	83	488.24%
18	82	455.56%
19	81	426.32%
20	80	400.00%
21	79	376.19%
22	78	354.55%
23	77	334.78%
24	76	316.67%
25	75	300.00%
26	74	284.62%
27	73	270.37%
28	72	257.14%
29	71	244.83%
30	70	233.33%
31	69	222.58%
32	68	212.50%
33	67	203.03%
34	66	194.12%
35	65	185.71%
40	60	150.00%
50	50	100.00%

EXAMPLE:**PROOF:**

SALE	= \$50	100% - 20% (PC)	= 80% (GP)
COST	= \$10	80% (GP) / 20% (PC)	= 400% Markup
GROSS PROFIT	= \$40		
MARKUP (GP/COST)	= 400%		

BAR SHORT TEST — CASE PROBLEM**EXHIBIT 13**

Page 1 of 3

A Bar Short Test will be compiled from the facts below:

Purchases and Sales Information

The purchase cycle for this case problem is one month. Selling price per drink and pour size were scheduled from Bar Fact Sheet.

Description	Purchases (Month)	Selling Price/ drink (tax inc)	Pour Size
Well whiskey, Ltr (\$175/cs)	\$2,800	\$ 3.00	1.5 oz
Call whiskey, Ltr (\$225/cs)	1,125	4.00	1.5 oz
Cocktails, Ltr (\$175/cs)	1,750	5.00	2.0 oz
Beer: Domestic, draft (\$80/ ½ keg)	1,040	2.00	10 oz
Beer: Domestic, bottled (\$13/cs)	325	2.50	12 oz
Beer: Domestic, off-sale (\$13/cs)	91	10.00	6 pack
Beer: Premium, bottled (\$16/cs)	192	3.00	12 oz
Total Purchases	\$7,323		

Self-consumption (SC)

\$100 per month; \$1,200 per year (well liquor)

Recorded Markup

	Cost of Goods Sold	Recorded/Reported Total Sales, tax inc	Recorded Markup (adjusted for SC)
1998	\$69,741	\$226,322	230.20 %
1999	\$74,390	\$253,530	246.40 %
2000	\$79,039	\$267,766	244.00 %

Purchase Percentages: Test period of one month

Purchases: test period of one month

Description	Total Cost	Percentage of Total
Liquor: Well (\$2,800-100)	\$2,700	37.38
Liquor: Call	1,125	15.57
Cocktails: Well	1,750	24.23
Beer: Domestic bottled	325	4.50
Beer: Domestic, draft	1,040	14.40
Beer: Domestic, off-sale	91	1.26
Beer: Premium, bottled	192	2.66
Total (net of self-consumption)	\$7,223	100.00

Expected Markup

Description	Cost	Selling Price (tax inc)	Markup Factor (tax inc)	Markup (tax inc)
Well, Ltr (12/cs)	\$175	\$746.64	426.65	326.65
Call, Ltr (12/cs)	225	995.52	442.45	342.45
Cocktails (Well liquor, 12/cs)	175	933.60	533.49	433.49
Beer: Domestic bottled (24-12oz/cs)	13	60.00	461.54	361.54
Beer: Domestic canned, off-sale (24-12oz/cs)	13	40.00	307.69	207.69
Beer: Domestic draft ½ keg	80	384.90	481.13	381.13
Beer: Premium, bottled (24-12oz/cs)	16	72.00	450.00	350.00

Solution

A	B	C	D	E	F
Year	Weighted Markup per Bar Short Test	Weighted Markup per Records	Difference	Weighted Markup Factor per Records	Percent of Error
			(B - C)	(C + 100%)	(D / E)
1998	363.53	230.20	133.33	330.20	40.38
1999	363.53	246.40	117.13	346.40	33.81
2000	363.53	244.00	119.53	344.00	34.75

Key Points

1. The weighted markup per Bar Short Test and the weighted markup per Records are both tax included.
2. Self-consumed merchandise and bar supplies are excluded before computing purchase percentages.
3. Computations are generally made on tax included basis.
4. Reconciliation between the weighted markup per the Bar Short Test and the Markup Per Records should be on the same basis (i.e., tax included or ex tax).
5. The anticipated proceeds from sales of one-liter bottles of distilled spirits (i.e., selling price per case) were scheduled from Exhibit 10.

AUDIT MANUAL

BAR SHORT TEST — CASE PROBLEM

EXHIBIT 13
PAGE 3 OF 3

BOE-1311-A REV. 3 (2-01)
BAR SHORT TEST SHEET

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

TAXPAYER NAME	ACCOUNT NUMBER	CASE NUMBER
DBA	TELEPHONE NUMBER ()	
AUDITOR	DATE	
RECORDS AT		

INFORMATION NEEDED TO SUPPORT MARKUP COMPUTATIONS OBTAINED FROM

TYPE OF DRINK		SALES PRICE	OZ. SERVED	(A) % OF TOTAL PURCHASES	(B) EXPECTED MARKUP	WEIGHTED MARKUP (A x B)
Well	BRAND <i>Whiskey</i>	3.00	1.5	37.38 %	326.65 %	122.10 %
Call	BRAND <i>Whiskey</i>	4.00	1.5	15.57 %	342.45 %	53.32 %
Cocktails (2 or more liquors)	BRAND <i>Gin/Vodka</i>	5.00	2.0	24.23 %	433.49 %	105.03 %
Wine/Liqueurs	BRAND <i>Bottled/canned</i>	2.50	12	4.50 %	361.54 %	16.27 %
Beer - Domestic	BOTTLED/CANNED <i>Off-sale</i>	10.00	12	1.26 %	207.69 %	2.62 %
	BOTTLED/CANNED OFF-SALE <i>Draft glass</i>	2.00	10	14.40 %	381.13 %	54.88 %
	DRAFT GLASS			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT PITCHER			%	%	%
	DRAFT PITCHER			%	%	%
Beer – Premium/ Microbrew	BOTTLED/CANNED <i>Bottled/canned</i>	3.00	12	2.66 %	350.00 %	9.31 %
	BOTTLED/CANNED OFF-SALE			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT GLASS			%	%	%
	DRAFT PITCHER			%	%	%
	DRAFT PITCHER			%	%	%
TOTAL WEIGHTED MARKUP				<input checked="" type="checkbox"/> Tax included <input type="checkbox"/> Ex Tax		363.53 %

MARKUP PER RECORDS (Adjusted for Self-Consumed)				<input checked="" type="checkbox"/> Tax included <input type="checkbox"/> Ex Tax	
YEAR OF			YEAR OF		
1998	230.20	%	2000	244.00	%
YEAR OF			AVERAGE		
1999	246.40	%	<i>Average</i>	240.20	%

SELF-CONSUMED MERCHANDISE

Self-consumed merchandise of \$ 100 / mo. or \$ 1,200 / yr. excluded before computing the percentage of total purchases and the markup per records.

COSTING OUT A MENU ITEM

EXHIBIT 14

COSTING OUT A MENU ITEM

Schedule _____ Page _____

Account No. _____

Case No. _____

Auditor _____ Date _____

Name of Item: Filet Mignon Dinner

REF	A	B	C	D	E
	Description	Unit	Unit Price	Portion	Cost per Portion
	Filet (85% yield)	1 lb.	\$ 8.00/lb	8 oz.	\$ 4.71
	Baked Potato	Each	\$.20	1	\$.20
	Vegetable	1 lb..	\$.80	4 oz.	\$.20
	Butter	1 lb.	\$ 2.00	2 oz.	\$.25
	Sour Cream	Qt.	\$ 1.50	3 oz.	\$.15
	Salad-lettuce	Head	\$ 1.30	4 servings	\$.33
	Dressing	Qt.	\$ 3.50	2 oz.	\$.22
	Sub-Total				\$ 6.06
	ADD: Waste, Spoilage, Spices, etc.(based on a %)				.60
	Total Portion Cost				\$ 6.66

	Selling Price	\$17.99
	Portion Cost	\$ 6.66
	Gross Profit	\$11.33
	Markup on Cost	170.12%

Comment:

This cut of filet mignon yields a serving 85% of its total weight. Therefore, one pound (16 oz) will actually yield 13.6 ounces. At \$8.00/lb, each ounce costs approximately \$.588. Serving size per dinner is 8 oz. 8 oz. x \$.588 = \$4.71 per serving cost of filet.

Additional Information:

- 16 ounces to 1 pound
- 32 ounces to 1 quart
- 128 ounces to 1 gallon
- #10 can equal 103.7 ounces
- #303 can equals 15.6 ounces

If the complimentary meals are provided in an area of the hotel where food and beverages are sold on a regular basis to the general public, the following decision chart should be used to decide whether the formula in Regulation 1603(a) applies and is controlling. If the meals are not provided in such an area, the formula should be applied to determine whether the hotel is the consumer or retailer of the complimentary meals provided.

